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Royal Commission on Banking and Finance

MR. BERNSTEIN

Hearings held at

OTTAWA

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ROYAL COMMISSION ON BANKING

AND FINANCE

- - - - - -

Hearings held at Ottawa,
Ontario, on Thursday,
September 13th, 1962.

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THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

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Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
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Dr. W. A. Mackintosh
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Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

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Ottawa, Ontario,
Thursday,
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--- AT 9:20 A.M. THE HEARING RESUMED:

THE CHAIRMAN: We will call the meeting to order.

We have this morning the submission from Mr. E. M. Bernstein, formerly of the United States Treasury, and he has also been head of the Research Department of the International Monetary Funds. He is now carrying on a private practice as a research economist in Washington, D.C.

We are very much obliged to you, Mr. Bernstein, for having come before us today. We have had the privilege of reading your brief and we have done so with great interest, and members of the Commission have a number of questions they would like to ask for the purpose of following up some of the points which you have raised and which perhaps may lead into other collateral discussions.

We will now proceed with the questions.

COMMISSIONER GIBSON: I take it that Mr. Bernstein is not going to make any statement first?

MR. BERNSTEIN: No, there is no need for it. I much prefer to answer questions.

THE CHAIRMAN: That is what I understood. I should have mentioned that.

COMMISSIONER GIBSON: Mr. Chairman, like the other Commissioners I have read Mr. Bernstein's

Chicago, Ohio

--- At 9:30 A.M. THE MEETING RESUMED:

THE CHAIRMAN: We will call the meeting to order.

We have this morning ... Bernstein's ... from Mr. E. M. Bernstein, formerly ... the United States Treasury, and I ... also ... the Research Department of the International ... Bank. ... Tunis. He is now ... as a treasury ... Mr. Bernstein, for ... we have had the ... and we have done ... of the Commission ... like to ask for ... the points which ... may lead into ...

Mr. Bernstein is not going to make ... first?

MR. BERNSTEIN: No, ... I much prefer to answer ... I should have ...

memo with great interest and benefit. I would like to start by asking some questions about the objective of monetary policy which are dealt with here in your memo, and to start that off I would ask you a question on how you define monetary policy. You make it clear in your statement of objectives that the objectives of monetary policy are broad and major ones, although you say later in the memo that they are not intended to include all the objectives of monetary policy. However, the objectives mentioned at the beginning, and three of the most common ones, are to maintain a high level of production and employment, minimize fluctuations in the economic activity and maintain approximate stability of prices and maintain stable exchange rates.

I take it in talking about these objectives you are assuming the use of much more than monetary policy for their achievement?

MR. BERNSTEIN: Yes. Let me see if I can make this clear once more. You have a monetary policy when the monetary authorities consciously and deliberately undertook a series of measures to achieve the desired end. It is by no means clear that monetary policy was of great consequence at all anywhere in the world prior to the 1930's or maybe even until the 1950's; there wasn't enough conscious effort to do these things.

Now, these suggested objectives in my memo can be achieved in large part by monetary policy. They are by no means the sole objectives of the govern-

of monetary policy which are dealt with here in your memo, and to start that off I would ask you a question on how you define monetary policy. You make it clear in your statement of objectives that the objectives of monetary policy are broad and major ones, although you say later in the memo that they are not intended to include all the objectives of monetary policy. However, the objectives mentioned at the beginning, and three of the most common ones, are to maintain a high level of production and employment, minimize fluctuations in the economic activity and maintain approximate stability of prices and maintain stable exchange rates.

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MR. DEWINETZKY: Yes. Let me see if I can make this clear once more. You have a monetary policy when the monetary authorities consciously and deliberately undertook a series of measures to achieve the desired end. It is by no means clear that monetary policy was of great consequence at all anywhere in the world prior to the 1930's or maybe even until the 1950's; there wasn't enough conscious effort to do these things.

Now, these suggested objectives in my ... can be achieved in large part by monetary policy. They are by no means the sole objectives of the govern-

ment in the economic field, and many things that governments do will bear on these questions.

There are some things that the monetary authorities cannot do which may be very important to the government in achieving economic objectives. For example, there is very little that the monetary authorities can do about the distribution of the national income. I doubt very much whether they can even effect very much the distribution between those who receive wages and those who receive other income by their monetary policy. This is an objective that simply is outside the field of the monetary authorities.

There are objectives like the structure of the output, how much of it should be domestic, how much of it should be in the export-import sector, how much of the investment should be financed with domestic savings and how much of an inflow of capital there should be -- these are questions where the authorities can exercise great influence but not be decisive.

Now, we move on from there. I think the reasonable dichotomy is between monetary policy -- that is, where the monetary authorities have a primary responsibility and where they can act on their own initiative -- and economic policy where the government, while it may have influence in the field of monetary policy, nevertheless acts on its own initiative in the fields where the economic objectives of policy are outside the sphere of the monetary authorities. But the notion of separating all

There are some things even the most fiscally conservative authorities cannot do which may be very important to the government in achieving economic objectives. For example, there is very little room for monetary authorities can do across the directorate of the nationalized income. I doubt very much whether they can even effect very much the distribution of income among who receive wages and those who are living other income of their monetary policy. This is an objective that clearly is outside the ken of the monetary authorities.

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of these things would be a little too difficult.

COMMISSIONER GIBSON: In other words, to achieve all these objectives implies the use of a co-ordinated government policy, including fiscal methods and so on.

MR. BERNSTEIN: That is right. In all these objectives I have mentioned, the monetary authorities may do a very good deal by themselves even if the government makes no conscious effort to achieve the same objectives. On other economic objectives they can do very little. Achievement of economic objectives will be much more successful if the monetary policy is co-ordinated with other action of the government. This is precisely what I have in mind.

COMMISSIONER GIBSON: In your experience of the study of the economies of many countries, do you have any preference as to the degree that monetary policy should be insulated from other government policies. Is there any view which you would like to express on this?

MR. BERNSTEIN: I think on the whole there should never be insulation. I mean, the monetary authorities can have a policy which is a conscious attempt to achieve certain objectives, and their policy can be negated by the accidental operations of the government in other fields. It seems to me this is not what an intelligent government would want to do. I would say, therefore, that monetary policy should always be in the forefront of the thinking of the government

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when it acts on other economic policy, just as the other economic policies of the government should be in the forefront of the thinking of the monetary authorities when they decide on monetary policy. Independence of monetary policy ought not to imply that a central bank works at cross purposes to show how fully independent it is.

COMMISSIONER GIBSON: There are, of course, great differences in the structure of economic policies between countries, and we have been told by witnesses from the United States, for example, and we heard a witness from Sweden yesterday, that there was quite a marked difference in the emphasis and the way in which these things are co-ordinated,and I was wondering if you have any particular preference in this area?

MR. BERNSTEIN: I think on the whole in a country like the United States -- but much less so in Canada -- monetary policy must be the first stage in achieving any economic objective. That is the case in a country like the United States with the congressional system and the independence of the legislature from the government itself. The time that is taken even for urgent legislation in the fiscal field is exceptionally long.

That means that the first stage in dealing with any problem would almost always have to be on the side of monetary policy. It doesn't, however, indicate to me that the role of fiscal policy should be on that account much less. I say in the

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United States we ought to be more concerned with fiscal policy in the long run objectives of the behavior of the economy. It is unlikely that fiscal policy will ever be as flexible -- at least, on the tax side -- as flexible an instrument as we would want if we were to put more reliance on it or for dealing with cyclical fluctuations.

COMMISSIONER GIBSON: Mr. Bernstein, you said a moment ago that monetary policy couldn't do a good many things to achieve major changes in the nature of the economy, and you gave a few examples. Now, in your analysis of your objectives of monetary policy you refer from time to time to what one might describe as structural adjustment. In any event, the problem of moving people and resources from weak industries into expanding or strong industries, and while you do say that monetary policy is not an effective instrument for achieving structural adjustments, you do make the point in a number of places that it is important that there be an adequate level of aggregate demand in order to facilitate these structural adjustments; movements from declining to expanding industries, and so on, and you did make this point several times. Now, I wonder if you could elaborate a little on just to what degree the monetary policy might facilitate adjustments of this kind?

MR. BERNSTEIN: Almost the whole of what could have been done with monetary policy in dealing with structual changes was somehow distorted during the

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1950 's because of the great excess of liquidity in the economy and the general tendency towards excess demand; excess liquidity having been built up during the great depression and during the Great War.

In a community in which there is a plentitude of jobs, the inducement to move to an industry where jobs are available and where wages are better and from an industry where jobs are less certain and wages are poor, is much greater than an economy in which there is considerable unemployment even in the growing sectors of the economy. You can get the most mobility at the stage where jobs are plentiful in the rest of the economy but there is some pressure in the declining sector.

This is the combination we really are after; a combination in which the growing industries are able to absorb nearly everybody who applies for employment and the declining industries have a surplus of manpower. In this sense a declining industry may be growing at one per cent per annum in output, which may be less than the increase in productivity per head. If you can conceive of this delicate balance, that is what we are after.

COMMISSIONER GIBSON: And you say this is being achieved as far as monetary policy is concerned by providing the right kind of climate rather than by specific intervention?

MR. BERNSTEIN: No, by other measures; you said"specific intervention".

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In a community in which there is a [illegible] preferences of jobs, the tendency to move to an income more jobs are available and where wages are [illegible] and from an industry where jobs are less certain [illegible] paying sectors of the economy. [illegible] mobility at the margin [illegible] part of the economy but there is some pressure in the expanding sectors.

This is the explanation we really are after: a combination in which the "rowing" industries are able to absorb nearly everybody who applies for employment and the declining industries have a surplus of manpower. In this sense a declining industry is [illegible] moving at one per cent per annum in output, there may be less than the increase in productivity and [illegible]. If you can conceive of this as [illegible] there is not the case either.

CHAIRMAN STEVENS: Mr. [illegible]

is being achieved as far as monetary policy is concerned by providing the right kind of climate [illegible] specific instruments?

MR. [illegible]: No, by quite [illegible] and [illegible] specific intervention.

COMMISSIONER GIBSON: No, I took it that you meant that monetary policy's function in bringing about a change is to provide the right economic climate.

MR. BERNSTEIN: Precisely.

COMMISSIONER GIBSON: But not to go further?

MR. BERNSTEIN: I don't think monetary policy can go further. It is not for the monetary authorities to create differential interest rates for regions -- for example, depressed areas and non-depressed areas or for industries, although to some extent practically all central banks do show discrimination in favour of some industries rather than others if they think it is in the national interest.

As Professor Lundberg pointed out yesterday, it is a realm in which you can run into a good deal of difficulty. I would prefer to have the government take these specific measures which increase the inducement to expand and make it very specific to an industry, to a place and even to a person if it wishes. The climate for inducing a transfer of resources is the task of the monetary authorities.

COMMISSIONER GIBSON: Now, you do place a lot of emphasis on wage policies in your discussion about the objectives of monetary policy. Is wage policy part of this picture? It is part of monetary policy, as you see it?

MR. BERNSTEIN: In my opinion it is a by-product of monetary policy. We have become so unhappy about the wage policy of the fifties that in a way we haven't

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been willing to analyse rationally what went on.

If I were to describe it, as I look at this problem, what went on was this. In the United States -- and Canada had almost the same problem -- the public was exceptionally liquid; it was fully prepared to spend, and business and the consumers together could spend much more than the output of the economy could supply. On top of this there were the exceptional needs of Europe which had to be met, and for which Canada provided large amounts of aid until about 1949.

Now, all this gave us an environment of inflation, and in this environment of inflation prices and profits went up. It is my opinion that by and large real wages, if you take the economy as a whole -- I will not take individual industries -- did not increase much more rapidly than productivity. But the rapid rise in wages may have caused a larger rise in prices or may have facilitated a quicker rise in prices than the community in any case would have had. It wasn't the wage earners or the wage policy which ran ahead of the inflation, it really was the inflation that came first. You can hardly blame the wage earners for wanting to defend themselves.

In 1948 or 1947 -- when the International Monetary Fund began working on the question of what the world structure of exchange rates would be, I wrote

a memo which was published as Staff Paper Number 1, and called "Latent Inflation". This paper was to the effect that the liquidity of the economy all over the world was so great that we would never absorb it except by a rise in prices and wages. A considerable part of that paper is concerned with the argument that if the liquidity is absorbed exclusively by a rise in prices that the imposition on labour would be unbearable. Once the excess liquidity was absorbed in the United States -- and it must have been absorbed at some time about the beginning of 1959 -- the pressure on wages in the United States has not been excessive.

I would say that the United States has shown once again -- and I believe that this is true in Canada, too -- that the sensitivity of the economy to the state of the market for labour is far greater than people had assumed.

I would guess off-hand that for these two countries the average rise in wages in the last two or three years hasn't been in excess of the average increase in productivity.

If we have monetary policy which is properly suited to maintaining aggregate demand, the probability is very strong that in ordinary circumstances we will avoid excessive wage pressures. Certainly in the kind of economy we have now where we are tolerant of considerable cyclical unemployment and where the community is prepared to accept this amount of unemployment as a natural by-product of a dynamic

economy, I would not be afraid that we would get excessive wage increases if we had the right policy and the right monetary environment.

COMMISSIONER GIBSON: In other words, without having what you might call a direct wage policy at all, would you think that the amount of increases you talk about in referring to the objective of stable prices for the -- stable wholesale prices for industrial goods, your 3 per cent per annum increase in wages might occur without any direct effort in that area?

MR. BERNSTEIN: I think so, although I do believe that there is an interval in which people have to get rid of the custom of 6 per cent annual increases, and adjust to wages increase that are more in accord with what the economy can do. It may be that in this interval, pressure by the government to indicate that there is public interest in keeping wage increases close to the increase in productivity can do no harm and it may do a great deal of good. But after better wage habits are established -- and they are being established now -- I do not think there is any need for wage management. I think you get better wage policy without wage management. I think it is the general experience that when governments get into setting wages in industry they get off on the wrong track on wage management.

COMMISSIONER GIBSON: So, it is your view that if appropriate monetary policies and appropriate fiscal policies are followed, with a little bit of general nudging wage policies should fall in line? In other words, it does not need to be a conscious policy?

MR. BERNSTEIN: That is right.

COMMISSIONER GIBSON: In a number of places, instead of having people moving between the declining industries and the expanding industries, you talk as though there should be significant wage differentials between declining and expanding industries, and you say that some of these differentials should even be wide. Again, you are looking to something that would happen in this general climate without there being a specific policy of government?

MR. BERNSTEIN: Moderate differentials in wages, together with better prospects for jobs, could be very effective in inducing workers to move from declining industries to growing industries. I should not like to see the present wage differentials, particularly between durable and non-durable goods industries widened any more.

My view is that these differentials are now excessive. They are much larger in the United States, for example, than in the United Kingdom. The difference between the highest wages in the United States and the lowest wages in major industries are much greater than the differences between the

same or similar industries in the United Kingdom.

My objection to these big differentials is not particularly social, though I would rather see the people with the lower incomes do better. My objection is economic. The inducement in a country like the United States or Canada to undertake investment is partly dependent upon the relationship of the wages in the machine-making industries and the wages in the maching-using industries; that is to say, it is dependent upon the price of machines and the rate of wages in the industries that use the machines.

In the United States we have probably kept a little lower than we should the inducement to keep using newer machines by having too high wages in the machine-making industries which raises the prices of the machines, and rather too low wages in the machine-using industries.

This is a problem that is partly met by investment credit and accelerated depreciation. These techniques cut the price of machines to induce more investment. Interest rates have the same effect. They cut the annual cost of using the machine.

COMMISSIONER LEMAN: Could this have been the result of other policy matters in the production field?

MR. BERNSTEIN: Yes, but there is no way by which you could have prevented wages rising in the automobile industry while they lagged in the

textile industry. In the United States you can only keep the textile industry at its present level by some degree of protection. You do not need to have any protection for the automobile industry. Part of that is due to the fact that the growth forces create wage differentials. You do not have to make these differentials. If you have a monetary environment in which the economy will respond with the growth it is capable of having then the wage differentials will emerge. That is how the wage differentials came about. They also reflect the relative strength of collective bargaining in different industries.

COMMISSIONER GIBSON: I think you heard part of Professor Lundberg's testimony yesterday. One of the points he made very strongly was that in Sweden an objective he thought desirable, and that the government also thoughtwas desirable, was a fairly uniform level of wages, and that this was a conscious matter of policy. As I understood him, his reason was that if wages were just about as high in the weak and declining industries as they were in the stronger and expanding industries the weaker industries would find it necessary to release workers and make them available to these other industries. He said that that was quite a conscious philosophy of stimulating desirable adjustments.

MR. BERNSTEIN: I do not think we could do very much about it, in any case, and that does bring us up against a set of alternatives that

always concerns us. If we tried to make wages in textiles as high as they are in other non-durable goods industries in the United States we would increase unemployment in textiles and that would have a good effect upon inducing people to move elsewhere. It may have the bad effect that they would not move at all. They would risk intermittent unemployment at better wages. You have to take your choice as between those alternatives.

I would say that in the past economists used to be in favour of very flexible wages, both for cyclical unemployment and structural unemployment. We now agree that cyclical flexibility in wages is undesirable. I think most economists in the United States prefer to have some differences in wages between declining industries and expanding industries. With smaller wage differences we take the risk of more unemployment in the hope that unemployment in the declining industries will force the labour out, and that high wages will force the businessman to get rid of labour as quickly as possible. Or we can have larger wage differences which will let these people go on working for the time being at sub-normal wages. These industries will not be attractive to youngsters and there will ultimately be a diversion of labour from one industry to another. In one case it may be slow with no unemployment, and in another it will be quicker with more unemployment.

COMMISSIONER GIBSON: If you do not push

it the consequences are much less serious. In other words, a deliberate effort to keep wages up in the weak industries might result in errors of judgment. Some of them might turn out not to be weak industries, and you will have pushed them back, so to speak, when it was not desirable to do so. There is an element of judgment required in it.

MR. BERNSTEIN: I would have thought that there is no need for specific action by the government on wages under ordinary circumstances. I might add that I look forward to a very ordinary world, one in which these strikingly large wage increases of the past will be much rarer than they have been. In such a world, I would think that the action of the government on wages should be limited to setting minimum wages where that may be necessary, and occasionally in having public boards arbitrate wage disputes in public utility industries, but not much more than that. I do not think there will be any need for it.

COMMISSIONER GIBSON: You think the day of cost-price inflation is over?

MR. BERNSTEIN: Yes, in the United States and Canada, and it will be over in Europe in a few years.

COMMISSIONER GIBSON: I was very intrigued by your analysis of why you felt the appropriate measure of price stability should be wholesale prices of industrial goods. You reject the idea that we should aim for stability in the cost of living

because that would imply a level of wage advances which you think might be difficult to make a practical matter; that there would be too low a wage increase ---

MR. BERNSTEIN: Too low to give us the flexibility we want. I do not say we cannot live in such a world, and have labour accustomed to a rise of 2 per cent a year, but ---

COMMISSIONER GIBSON: And that is your objection to working in terms of a stable cost of living index?

MR. BERNSTEIN: Yes, in a way that is the principal one because the secondary one is that the interest rate would also have to be adjusted, and that is mainly significant because it would impose on the monetary authorities an environment in which it is difficult to manage monetary policy but by no means impossible. The world has lived in the past with low interest rates for very long periods. If we have to live in a world in which 3 per cent, instead of 4 per cent, is the rate of interest which the monetary authorities must somehow achieve to attain their objectives -- one of the objectives being stability of the cost of living ---

COMMISSIONER GIBSON: But this does not follow. You assume a 2 per cent increase in wages, and you say if you have that, and taking into account other assumptions, you have to have a one per cent decline in interest rates, but there are permutations of this which will work just as well.

MR. BERNSTEIN: I am afraid not, Mr. Gibson. In fact, if you run through the drill on the inter-relationship of wages, prices and interest rates you will come to agree with the proposition that if you have a price level -- say, a cost of living that remains stable -- and another price level, that for industrial goods at wholesale, which is declining at the rate of one per cent a year, then the interest rate will have to be one per cent lower than it would have been if wholesale prices had been kept stable. That proposition is, in my opinion, unimpeachable.

COMMISSIONER GIBSON: But could not wages have less of a squeeze or profit margins or organizational efficiency affect the picture?

MR. BERNSTEIN: No, I do not think we can bring in organizational efficiency. That is bringing in something extra. I do not think that we can assume other than that there will be a squeeze on wages and profits, and then precisely because of the squeeze non wages and profits, there will be a squeeze on interest rates.

Let me show how that works. When a businessman considers whether to undertake investment, and decides what he can afford to pay for the capital going into his investment, he undertakes a very complex projection. He says to himself if he does it consciously -- and sometimes he may do it with pencil and paper. "This machine is going to have a certain capacity of output. We ought to be able to

MR. BENNETT: I'm afraid not, Mr.
Chairman. In fact, if you run through the until on
the labour-relationship of wages, prices and income
income you will come to agree with the proposition
that if you have a parks level -- now, I come of
living that remains stable -- and monetary policy
level, that for industrial goods at whatever
price is obtained at the rate of one per cent
a year, then the interest rate will have to be
one per cent lower than it would have been. If
monetary policy had been kept steady. This
proposition is, in my opinion, unsupportable.

CHAIRMAN: Did you ... [illegible]
the law or a purpose or public purpose by
organizational efficiency other the pleasure?

MR. BENNETT: No, I do not think we can
in anything ever. I do not think that we can
assume other than that there will be a squeeze
on wages and profits, and then precisely because
of this squeeze on wages and profits, there will
be a squeeze on interest rates.

Let me show how that works. When a
multinational considers whether to undertake investment
and decides what he can afford to pay for the capital
going into the investment, he undertakes a very complex
projection. He says to himself if he does it
domestically -- and somewhere he may do it also

use it a certain percentage of the time for producing goods. The goods ought to be selling "-- and this is absolutely important in his computations --" ... These goods ought to be selling at an average price of so and so in the future. I ought to be able to get my labour and materials at such and such wages and prices. Then I will have a gross return from this machine which will cover the interest and depreciation cost which I incur by investing in this machine." Now, if he must project for his output a declining price level -- he is selling at wholesale, you see -- the amount of investment that he is willing to undertake at any given rate of interest would be less than what it would be if he had to project a constant price level.

COMMISSIONER GIBSON: Unless he projects other declines in costs.

MR. BERNSTEIN: He may project other declines in costs, but actually with that machine he does not project other declines in cost. A businessman buying a machine today knows that the cost of producing with that machine will be absolutely at its lowest level now, because wages will be higher next year and the year after that while the technical efficiency of that machine will not change. It may well be that a businessman gets 80 or 90 per cent of the net return he will ever get from a machine in the first five years, because he buys this machine at a certain price, it has a certain technical efficiency, and the goods that he sells, with good fortune, will be

selling at the same price five years from now that they are selling at now; but in the meantime wages are going up. So, in fact, his net return tends to be less and less, and that is why he can set up a rule of thumb by which he can get his money back within five years.

It is quite true that at the end of the fifth year he may well be getting from the machine something in the way of a return, and this enters into new calculations he makes as to whether he should replace the machine.

But, this is carrying us away from the proposition that I would like to emphasize once more. If the prices which businessmen get for the products they are turning out with their labour and machinery are declining they will be inclined to pay lower wages than they would otherwise pay, and they would be inclined to borrow at interest rates which are lower than they would otherwise pay. Even their profits in dollar terms would be a little bit less. Everybody would absorb part of the declining money value of the same output as compared to what the situation would have been at a constant price level. I do not think we can escape this.

Besides, if we just go to the economic bibles on the question we will find that there is a general recognition that in a period of falling prices interest rates will go down to offset part of the fall in prices, and in a period of rising prices they will go up to offset part of

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the rise in price. There is that tendency. I do not think we can dispute it.

COMMISSIONER GIBSON: You are almost saying that a businessman makes certain calculations based on certain assumptions about wage rates, and it is those assumptions that are really more important than the facts in their immediate investment decisions. In other words, you say they assume that certain wage increases will occur over the period.

MR. BERNSTEIN: That is right.

COMMISSIONER GIBSON: And on that assumption the businessman makes his calculations. To go on from that, this really suggests that because people make these assumptions one must see that the facts more or less conform to them.

MR. BERNSTEIN: I do not mean we have to conform. We can get businessmen to make any assumption we want very easily by merely creating the environment by which those assumptions have ordinarily been realized in the past. Businessmen live by expectations, and the realization of their expectations is an important part of getting an improved pattern of behaviour.

If you want businessmen to think that wages are not going to go up at a certain rate, one way of doing it is by not having wages go up at that rate for a time. My guess is that businessmen do not err very much in regard to what is going to happen to wages and prices in the short period that is in their minds. When they are projecting wages going up by 6 or 7 per cent a year they are also projecting

in trade. There is that comment. I do not think we can dispute it.

COMMISSIONER GIBSON: You are welcome.

based on certain assumptions about wage trends, and if in those assumptions wages are really more important than the facts in their immediate context, in other words, you say they assume that certain wage increases will occur over the period.

MR. LEMENCHUK: That is right.

COMMISSIONER GIBSON: And on that assumption the businessman makes his calculations. To do so does that, this really suggests that because people make these assumptions one must see that the facts more or less conform to them.

MR. LEMENCHUK: I do not want to make to conform. We can get confirmation to make or determine we must only small or merely changing the emphasis of course those assumptions have occurred in the past. Businessmen tend to extrapolate from the realization of their expectations in imperfect part of getting an idea to perform or other items.

If you want evidence, to take the ... are not going to go up at a certain time, or any of these in my not saying where to go at any rate into a time. I guess is that businessmen or you say you assume it must in going to reduce ... [illegible] ... wage trends. When they are predicting wage trends,

the fact that they can raise prices, and they are not at all deterred from investing at that stage. But, suppose we give them the datum that wholesale prices cannot rise, but will fall, they will still do the business they want to do, but we will find that the interest rate will have to be, say, one per cent lower.

COMMISSIONER GIBSON: In effect, you are saying that businessmen making investment decisions will be discouraged in terms of the volume of decisions they make if they look forward to a declining level of industrial prices?

MR. BERNSTEIN: It is almost that.

COMMISSIONER GIBSON: You will get a too low level of investment under those circumstances?

MR. BERNSTEIN: Yes, unless you can simultaneously create the other expectations of wage rates rising less and of interest rates staying one per cent lower -- when you have created all these expectations together you will have had no effect on investment. You will, however, have made difficult the implementation of monetary policies. For the monetary authorities the task will be greater for the simple reason that the cash that the public would hold relative to production, consumption and income is much greater at 2 per cent than the amount they would hold at 3 per cent. If the basic forces of demand should increase, the capacity of the monetary authorities to manage the liquidity of the public would be much more difficult.

I might repeat some of the experience of the 1930's. In the 30's the United States created so much liquidity that it became a burden in the 1950's. The great increase in liquidity in the United States was due primarily to the inflow of gold. On top of that the commercial banks bought large amounts of government securities in the depression. That combination brought about the big increase in liquidity.

The credit created by the Federal Reserve was insignificantly larger in, say, 1940 than it had been in 1934. This did not seem like too much liquidity at that stage, and bill rates were about one and a quarter per cent and interest rates on government bonds were 3 per cent. But in a different environment in the 1950's when real demand was very great that liquidity became unmanageable for the monetary authorities.

All things considered, I would say the task of the monetary authorities would be more difficult if the rate of interest with which they must work is 3 per cent rather than 4 per cent, and even more difficult if it is 2 per cent rather than 3 per cent.

I think, by the same token, the capacity of trade union leaders to take a reasonable view of wage policy is probably also more difficult at a 2 per cent average wage increase per annum than with a 3 per cent increase. This is all on the domestic side.

Then, on the international side, as we have no reason for thinking that the relationship of wholesale prices to the cost of living would be the same in all countries, you would be building in, as it were, a distortion in the relationship of import-export prices in different countries. That would have to be offset by minor deviations in the stability of the cost of living, to avoid adverse international deviations in export-import prices.

COMMISSIONER GIBSON: This leads us to the broader question of whether you see any real conflict between full employment and reasonably stable prices. You, in effect, say: no, not with the kind of objectives you set out.

MR. BERNSTEIN: Mr. Gibson, these are quantitative things. In a country like Canada or the United States we are very content with having unemployment seasonally adjusted in the best months of a cyclical expansion at around 4 per cent of the labour force. As we have a very generous test of unemployment in the United States and Canada this is really equivalent to 2 per cent in the United Kingdom, because their method of computing unemployment is quite different from ours. They are there very cautious about calling anyone unemployed, whereas we are very bold.

COMMISSIONER GIBSON: You say that our system is very much the same as yours?

MR. BERNSTEIN: Yes, your system is very

much like ours; and the European systems all have a common pattern too. This fact probably grows out of their sociological structure. We had unemployment statistics before we had unemployment insurance; and they had unemployment insurance before they had unemployment statistics.

They link unemployment to two things. A person has to be employed at some stage before he can be unemployed; and no youngster looking for his first job is ever classed as "unemployed" in England. Secondly, the worker must come down and register at a labour exchange and be prepared to take any reasonable job that is offered to him.

In the United States we merely ask, "Are you unemployed and looking for a job?" and all he has to say is, "Yes,"and we then class him as "unemployed".

A test made in Sweden showed that this results in a difference of roughly 2 per cent in the unemployment rate so we must not be frightened by the fact that in England and on the Continent generally their definition keeps unemployment below 2 per cent while with our definition of "unemployment" the equivalent would be around 4 per cent.

If we had about a 4 per cent unemployment rate at the cyclical peak and, say, 6 per cent unemployed for a very short time at the cylical low, my guess is that we would have no trouble whatever, in the present environment and the one I project for the future, in avoiding a tendency for a rise in the index for wholesale prices of

domestically produced industrial goods. I do not see any conflict between a high level of employment and price stability in Canada and the United States. When the Europeans have less inflationary pressure they will not have a conflict either.

COMMISSIONER GIBSON: Coming back to your statement about there being otherobjectives to monetary policy than this one, you referred to there being long periods when the forces of expansion are not as strong, and you say that in those circumstances it is appropriate that monetary policy should facilitate the creation of sufficient demand to stimulate the use of idle resources. This is quite unexceptionable in a general way, but what happens when this kind of situation is combined with either a real or potential balance of payments problem? We now face a real one and you, perhaps, face a potential one.

MR. BERNSTEIN: Maybe both are exaggerated.

COMMISSIONER GIBSON: Possibly, but ours is not a figment of the imagination.

MR. BERNSTEIN: Nor is ours, but they are exaggerated and the problem will, in fact, be solved both in Canada and the United States; I am confident of that.

Let me see if I can answer Mr. Gibson's question which is, in a certain sense, the key to the problem of reconciling domestic and international objectives of monetary policy.

The United States and Canada had a very rapid rate of growth from 1946 to 1955 or 1956.

This rapid rate of growth was largely due to the fact, excluding excessive liquidity, that real demand was exceptionally large because of the carry-over of a big depression and war-generated deficiency in consumer durable goods, plant and equipment and housing. In the United States we reached a secondary trend peak in the expenditures on consumer durable goods -- particularly for automobiles -- in 1955. In Canada you reached the same peak at about the same time. But while this peak was reached and demand was declining we had a continuously growing investment in plant and equipment. In the United States that reached its peak in 1957; in Canada it reached its peak in 1956. Did I say that Canada reached its peak in 1956?

THE CHAIRMAN: Yes.

MR. BERNSTEIN: It is 1957 for plant and equipment investment -- the same year in Canada as in the United States.

After such investment reached its peak, Canada and the United States still had a rapid rise in residential construction. You reached your peak in residential construction in 1958, and we reached our peak in 1959.

Both countries have been suffering from the fact that these three high output sectors of the economy have been unable in 1962 during a cyclical expansion, to reach the peak in dollar amount -- not just in volume, but in dollar amount -- that they had reached, seven years before for consumer durable goods,

five years before for plant and equipment and three or four years before for residential construction. This is the problem that confronts us now.

I regard the present as an interval between rising trends for these forms of expenditure and investment. I feel reassured in this view by the fact that we already see the automobile demand exceeding the previous peak in Canada. In the United States we may expect to exceed the previous peak in the demand for automobiles in the next cycle.

I expect that the United States and Canada will, once again, start an upward trend in plant and equipment expenditures in the expansion phase of the next cycle. But I do not think that residential construction, in the United States, in any case, will be back on a rising trend for a few years more.

We had a very rapid growth trend in 1956 or 1957; then this period of slower growth we have now. We may expect a more satisfactory rate trend again about 1964 or 1965. I am confident this will work out. Neither Canada nor the United States has an economy which is going to stagnate. That is not the trouble we are in; and it is not a proper diagnosis of our difficulties.

The United States has a balance of payments problem which is largely the consequence of the slowness of adjustment of national realities to a changed world economy. There is no reason why we should not have dealt with this balance of payments problem before, but we kept assuming Europe was weak,

five years before for plant and machinery and three
or four years before for residential construction.
This is the problem that confronts us now.

I refuse the attempt to do national planning
starting merely for three years of unemployment and forget-
ting. I feel responsible in this view by the fact
that we already see unemployment declined somewhat
the previous peak in January. In the entire country
for automobiles in the past year
[illegible] to do more [illegible].

I regret that the United States is thus
still, once again, going to unload [illegible]
upon the rest of the world. But I do not think they [illegible]
the usual trade. But I do not think they [illegible]
[illegible] in the United States, in any case, will
[illegible] a really [illegible] for a few years [illegible]

We had a very [illegible] world [illegible]
[illegible] from this period of slump [illegible] we [illegible]
now. We are experiencing a more [illegible] kind
again about 1926 or 1925. I am convinced this will
work out. Various dangers for the United States or
[illegible] would be trying to [illegible]. This [illegible]
[illegible] we are in [illegible] and it is not a [illegible]
of our difficulties.

The United States has a feature of [illegible]
problem which is largely the consequence of the
slowness of curtailment of national [illegible] in a
changed world economy. There is [illegible]
economy that have dealt with [illegible] of reason
[illegible] the most [illegible] [illegible]

with the result that we were more than a little staggered to realize that it is an extremely powerful economy with a strong competitive position. The United States balance of payments problem is caused largely by political factors -- our aid and military expenditures. Something can and is being done about that. Beyond that, we have gone through a period of exceptional capital outflow, specifically related to making good the deficiencies in U.S. foreign investment in the 1940's and 50's. I believe the United States is already past the peak of that. So I am rather optimistic about the United States balance of payments.

But even though I am optimistic about both these problems -- the one which makes the world afraid of the dollar, and the other, which conjures up continued large-scale unemployment -- the plain fact is that a country can have a balance of payments deficit in a period when it has considerable unemployment.

For that, what should we do? I hold that during such a period the monetary authorities must make credit easier, not as much as they would if there were no balance of payments deficit, but definitely easier. I would bring short-term interest rates down, if they were 4 per cent to 2 per cent, or $2\frac{1}{4}$ per cent in a recession. And if there is a balance of payments problem during a period of high employment, I would expect the monetary authorities to avoid extremely high interest rates. In short, I would have all countries keep their monetary policy within reasonable limits, but flexible in order to deal with the

employment problem.

If the United States and the United Kingdom will limit the adjustments in interest rates in response to cyclical fluctuations in production and employment to this hypothetical range of 2 to 2¼ per cent at the bottom of the recession and 4 or 4½ per cent at the peak of the boom, then, any consequential capital outflows could be met from special resources available for that purpose. I do not ask countries to give up a flexible monetary policy: I ask them to use it within this range. In my opinion, monetary policy will give nine-tenths as much response between 2 per cent and 4½ per cent for short-term money as between 1 and 6 per cent. It is the 6 per cent short-term rate and the 1 per cent rate that is dangerous. In this range, if there were capital movements, I would deal with them by having special resources.

COMMISSIONER GIBSON: You say, the short-term range ---

MR. BERNSTEIN: This is for the United States; it would have to be higher for Canada.

COMMISSIONER GIBSON: -- this would be sufficient to bring about the adjustments in wages -- that is, the lower increase in wages which you desire and say is essential in the process of adjustments?

MR. BERNSTEIN: No. This will not act on the wages yet.

I thought we started with the assumption that we have a cyclical movement in production and

employment, and we want to know how much we are going to be hampered by balance of payments problems.

COMMISSIONER GIBSON: But you said that in the process of expanding it was necessary to have wages rise less rapidly?

MR. BERNSTEIN: Yes. This is a separate problem which happens to be running concurrently during a recession, though it will continue during the recovery too. That is to say, the balance of payments may be weak if you are in balance only in the recession. You may then have a large deficit in the expansion period. To deal with that problem the community must find a way of keeping wages from rising as much as the increase in productivity. This means that if wages would otherwise have risen by, say, 15 per cent over a five-year period or 10 per cent over a 3-year period, that being the increase in productivity, it would be necessary to hold the wage rise down to 10 per cent over five years or 7 per cent over three years. This is on the assumption that countries are aware that they must not let their balance of payment get so much out of order that it takes radical measures to deal with it. This creates a problem, not only in a recession, but even as to the restrictiveness of the monetary policy that must be applied during an expansion. I would say that such an economy will begin to feel pressures on home employment in two places. The export industries will not be exporting as much, and if that is so you will have a little more unemployment in these

industries. In the import-competing industries you have the same problem. And it is a serious problem where growth has been running at 3 per cent a year and it is discovered that there is a tendency toward a balance of payments deficit. Then instead of having 4 per cent unemployment at the peak of the cycle, it may be necessary to let unemployment be a little more than that. You would hope that the export and import-competing industries will become so alerted to the necessity of remaining competitive that businessmen and wage-earners will take a slightly more cautious attitude towards wage increases.

I would not say to the monetary authorities of a country like the United States or the United Kingdom, "You have a balance of payments problem. Do not pay any attention to unemployment. The dollar and sterling are, after all, something sacred, and we must not let the balance of payments be out of order." I would say, "Deal with your balance of payments problem as best you can, but deal with it promptly, bearing in mind that it is undesirable to press too heavily on the domestic economy."

When interest rates are set too high because of a balance of payments deficit, it hurts the domestic economy and it hurts other countries. I believe that it was a serious mistake for the United Kingdom to put bank rate at 7 per cent. Mr. Leaf once said that 7 per cent in London would bring gold from the moon. The trouble is that 7 per cent also brings gold from the United States and

I don't believe that is a reasonable way to deal with a balance of payments deficit in the present world.

In the interests of the United Kingdom and of the United States and of the world economy, we have to develop a policy in which the cyclical movement of interest rates would be in a somewhat narrower range. If there are still some capital movements as a consequence of relatively low interest rates when there is unemployment, we can deal with that through special resources available for that purpose. If a country has a balance of payments deficit at such a time, and its own reserves are inadequate, there will be the special measures of the I.M.F. available to help it. But a country does not neglect a balance of payments problem because it has unemployment or neglect the employment problem because it has a balance of payments deficit. This does require a country to be alert to its balance of payments and to avoid letting it reach a critical stage.

COMMISSIONER GIBSON: When you say deal with the balance of payments problems as best you can and don't use your monetary policy to solve the balance of payments problem, does this imply that you take certain direct measures with regard to your balance of payments problem, is that correct?

MR. BERNSTEIN: I would only take direct measures in an emergency.

COMMISSIONER GIBSON: What do you mean, to deal with it as best you can?

MR. BERNSTEIN: You can use fiscal policy

to some extent. I was thinking of this; if you have a period of unemployment and the balance of payments problems is not critical, then let unemployment at the peak be 6½ per cent instead of 6 per cent and let it fall to only 4½ instead of 4 per cent. This extra one-half per cent of unemployment would hold down the pressure of wages. I am not in favour of keeping 6½ or 7 per cent unemployment steadily until the balance of payments problem is solved. Then a moderately restrictive monetary policy, reinforced by fiscal policy, will give the extra margin to take care of the balance of payments problem. That will be enough if the balance of payments is not critical. In the kind of world in which we live countries must not neglect their balance of payments problems too long. If they deal with them in good time, moderate corrective action will correct the balance of payments difficulties. In the world I foresee, we will not have so much distortion in international payments that it cannot be dealt with reasonably well through moderate monetary measures reinforced by other measures such as fiscal policy.

COMMISSIONER BROWN: Is this range of 2 per cent to 4 per cent on interest rates a sufficient differential to be effective, particularly in the periods of high corporate income tax?

MR. BERNTSTEIN: I don't think that corporate income tax has quite as much effect as people think on the role of interest rates. With 50 per cent income tax rates, a company that makes an

investment and borrows the money can charge half that as an expense and if it has a loss on the investment it can charge that off against other income.

With the 50 per cent income tax rates we have another scale of measurements to which all the inter-relationships respond. The response to interest rate differentials caused by high income taxes is not very different after the high taxes have been in effect for some time. There are marginal places where the effect of interest rates is uneven because of high tax rates. Nevertheless, the economy will respond considerably to changes in interest rates between 2 and 4 per cent. I believe that the effectiveness of interest rates depends considerably on whether people think the present rates will last and how they compare to what people are accustomed to think of as normal rates. So that it is the relationship between interest rates that counts rather than the absolute level.

COMMISSIONER BROWN: Will this range be sufficient to effect the availability of money?

MR. BERNSTEIN: Oh yes.

COMMISSIONER BROWN: Which do you think will be the most important point, the availability or the increase?

MR. BERNSTEIN: Probably we can make a distinction between the two, and I have found some illustrations of how to show the difference. The availability would be the more important. Let me show you what has happened in the United States.

In the United States we have had in

this cycle a unique monetary policy. There had not been such a monetary policy in the post-war period. This policy has provided, during a period of expansion, a positive level of free reserves; that is to say, excess reserves held by the member banks of the Federal Reserve System above their borrowings from the Federal Reserve Banks. The level of free reserves is now considerably higher than has ever prevailed in the United States in a cyclical expansion since 1949. This went along with a 2¼ per cent interest rate on Treasury bills when free reserves were about $500 million on a daily average basis. When it was decided to let the bill rate rise to 2-3/4 or 2-7/8 per cent, the Federal Reserve reduced free reserves from $500 million to $300 million. We will go through the whole cycle without any net indebtedness from the banks for the first time in any expansion since 1949. This is a new policy. You can get plenty of availability of credit nowadays at a 2¼ per cent bill rate. It was just as available in this cycle when the rate was 2¼ per cent on treasury bills as it was in 1958 when it was down to four-fifths of one per cent. There was no difference in the availability, but there was a difference in the interest rates.

COMMISSIONER GIBSON: Would you care to say a word about the Canadian situation in this context? You have given us a very interesting analysis of the American picture.

MR. BERNSTEIN: On employment or

COMMISSIONER CLEGG: Would you care to say a word about the Question attached to that document? You have given us a very interesting analysis of the Federal Reserve decisions.

Interest rates.

availability, but there was a difference in the of one per cent. There was no difference in the ability as it was in 1929 when it was down to four-fifths in this cycle when the rate was 2½ per cent on Treasury at a 2½ per cent bill rate. It was just as available You can get plenty of availability of credit nowadays in any expansion since 1949. This is a new policy net indebtedness from the banks for the first time We will go through the whole cycle without any reduced free reserves from $500 million to $300 million, to 2-3/4 or 2-7/8 per cent, the Federal Reserve basis. When it was decided to let the bill rate rise reserves were about $500 million on a daily average cent interest rate on Treasury bills when free expansion since 1949. This went along with a 3/4 per has ever prevailed in the United States in a cyclical of free reserves is now considerably higher than borrowings from the Federal Reserve Banks. The level banks is to say, excess reserves held by the member of the Federal Reserve System above their of expansion, a positive level of free reserves; period. This policy has provided, during a period not been such a monetary policy in the post-war

India cycle a unique monetary policy. There had

production?

COMMISSIONER GIBSON: In relation to the balance of payments as you did in the United States.

MR. BERNSTEIN: First I want to tell you that the U.S. balance of payments is, in my opinion, well on the way to solution. In correcting the U.S. balance of payments it will turn out to be that the big immediate factor will be the change in capital movements, but other net payments will also decrease. The Defence Department has taken steps to persuade our allies in Europe to make off-setting expenditures in the United States equivalent to our troop expenditures, and the United States has commitments from most of our allies to do this. In about two or three years, instead of having a deficit of $3 billion from overseas defence expenditures, net payments will be down to a billion dollars or less. Aid is another drain on the U.S. balance of payments. Under the Marshall Plan aid money could be spent anywhere. That is being changed. Now more than 80 per cent of the aid money will be tied to purchases in the United States. This will have an important effect. On top of that, a radical change is already taking place in the capital outflow, although people are not generally aware of it.

Take the two major types of capital flow -- long-term direct investment and short-term liquid funds. Immediately after the war U.S. companies began to re-construct their own plants abroad. They did not increase their expenditures to any considerable extent and particularly not with new funds of their own.

After a time, having decided that the postwar world was not all bad, they began to increase direct investment in Canada.

This was followed by large direct investment in Latin America. It wasn't until about 1955 that American companies began a period of rapid investment in Europe. I don't know whether the peak of new U.S. funds going into direct investment in Europe will be reached this year or was reached last year. In any case, as U.S. direct investment in Europe is flattening out, the total is going down. I expect U.S. direct investments in the next five years will be declining slightly until, at the end of five years or six years they will be around $400 million a year less than at the peak -- say, down from around $1.7 billion to $1.3 billion a year. This is best explained as a matter of restoring the position of the U.S. in the world as an investor. At the end of 1961, the proportion of U.S. direct investment in manufacturing by regions -- Europe, Canada and Latin America -- was about the same as in 1929 and 1936. Now that we have made good our deficiency, the total of new funds going into direct investment abroad is declining.

Precisely the same thing is true with our liquid funds, particularly loans by U.S. banks. Our banks were very reluctant to increase their lending to foreigners outside Canada, until about 1958. In that year they came to the conclusion that there was a lot to be made by lending abroad and in the three

years, 1959, 1960 and 1961 our banks increased their foreign loans by nearly $3 billion. The normal rise, related to the business they do in the world, should have been about $300 million or $400 million a year. In 1961 they increased their lending by $1.4 billion in one year.

I think U.S. banks have also reached the level of credits they want to have abroad, and in the first six months of this year they have increased their lending by only $220 million. The decline in capital outflow this year will be substantial and there may be a further decline next year. For this reason I would expect that U.S. payments will be coming into balance very soon.

COMMISSIONER GIBSON: You can see a saving over the next three years of perhaps $3 billion?

MR. BERNSTEIN: Yes. In fact, we will have a surplus if you give us three years' time. This is without discussing the question of whether the competitive position of the American economy isn't likely in the long run to show greater strength than that of some of the European countries. I am not ready to write off the productive efficiency and technology of the United States and Canada in relation to Europe.

Despite this, we may have an outflow of gold from the United States after the balance of payments is in order, because during this period of deficit some of our friends accumulated more dollars than they want. If the U.S. gets to be a surplus country again

the inducement to convert dollars into gold will manifest itself once more. I wish I could say that the Canadian payments problem will be as easy to solve as the U.S. problem. As our payments position improves yours will, too. Some of the forces acting on the balance of payments are the same. If your payments problem were merely a question of keeping your over-all accounts in balance, it would not be as serious as some people think; but I have the feeling that the Canadian balance of payments is part of the structural adjustment problem that this country must meet.

It is undesirable from the point of view of economic policy for a country like Canada to have such a higher level of capital inflow in 1962 compared to 1950. You are financing more of your gross investment from foreign funds now when your output is 25 or 30 per cent higher in real terms than it was then. In my opinion if you do not increase the export sector of your economy and decrease your dependence on capital inflow, your problem of maintaining a high level of production and employment will be more difficult to meet.

It is not a question of whether you will be able to balance your accounts; you will always be able to balance your accounts because you can induce the capital inflow to do it. But I think you will have much more difficulty in maintaining a high level of production and employment in the next five years with this level of capital inflow than you would have at a low level of capital inflow.

manifest itself once more. I wish I could say that the Canadian payments problem will be as easy to solve as the U.S. problem. As our payments position improves with, too. Some of the forces acting on the balance of payments are the same. If your payments position were nearly a question of keeping your over-all economy in balance, it would not be as serious as some people think, but I have the fiscal and monetary conditions of payments in part of the international adjustment problem that this country must meet.

It is understandable from the point of view of economic policy for a country like Canada to have such a higher level of capital inflow in 1960 compared to 1950. You are financing more of your growth from foreign funds now when your output is 2% or 30 per cent higher in real terms than it was then. To the extent it can do not increase the dependence on capital inflow, your problem of maintaining a high level of production and employment will be more difficult to meet.

It is not a question of whether you will be able to balance your accounts. You will always do more to balance your accounts because you can reduce the capital inflow to do it. But I think you will have much more difficulty in maintaining a high level of production and employment in the next five years with this level of capital inflow than you would have at a low level of capital inflow.

THE CHAIRMAN: We will adjourn now for a few minutes.

--- A short recess.

COMMISSIONER MACKINTOSH: Mr. Bernstein, I would like to intervene in this discussion of international matters and go back for a moment to your objectives, specifically the stability of the exchange rate. Your argument, as I understand it, is that a stable exchange rate helps domestic stability more than a floating exchange rate?

MR. BERNSTEIN: Where the stimulus to instability originates at home.

COMMISSIONER MACKINTOSH: Yes, and is this entirely because the floating rate is likely to create price movements?

MR. BERNSTEIN: Not merely that. That is part of it. It creates price movements that you do not want. But my preference for a fixed rate is based largely on its cyclical effect on production and employment. The fixed rate is contra-cyclical in its impact on unemployment. In a period of recession exports will increase, and so the current account will improve with a larger surplus or a smaller deficit, and that will aid employment. In a boom there will be the opposite effect. Imports will rise relative to exports. The current account position will deteriorate slightly, but this is all to the good in stabilizing cyclical fluctuations in production and employment.

THE CHAIRMAN: We will adjourn now for a few minutes.

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COMMISSIONER MCCLENNON: Mr. Bernstein, I would like to intervene in this discussion of international matters and go back for a moment to your objective, specifically the stability of the exchange rate. Your argument, as I understand it, is that a sizable unhedge rate helps domestic industry more than a floating exchange rate?

MR. BERNSTEIN: Where the objective is primarily orientated at home.

COMMISSIONER MCCLENNON: Yes, and is this entirely because the floating rate is likely to create price movements?

MR. BERNSTEIN: Not merely that. That is part of it. It creates price movements that you do not want. But my preference for a fixed rate is based largely on its cyclical effect on production and employment. The fixed rate is counter-cyclical in its impact on unemployment. In a portion of recession exports will increase, and so the current account will improve with a larger surplus or a smaller deficit, and this will add employment, on a good there will be the opposite effect. Input is will rise relative to output. The current account position will deteriorate slightly, but this is all to the good in alleviating cyclical fluctuations

Now, a floating rate is neutral on the current account side of the balance of payments. It does not intensify your recession, but it does not alleviate it. As between having a neutral policy and one which acts to give you more employment in a recession and to hold back the strain of full employment in a boom, I would rather have the contra-cyclical type of behaviour. This is apart from the fact that a fluctuating rate tends to exaggerate the cyclical movements in prices.

COMMISSIONER MACKINTOSH: I followed your exposition of the distinction between the operation of the gold standard and the operation of the International Monetary Fund rules. Does not the thinking of the Monetary Fund, in some degree, contemplate the control of capital movements in the sense that with control of capital movements there is an opportunity to consult if there is a fundamental disequilibrium? If your capital market is completely open and a fundamental disequilibrium emerges, are you not likely to have a fairly catastrophic situation?

MR. BERNSTEIN: It is true that when the Bretton Woods proposal was being discussed some people objected that the Fund was designed to control capital movements. The Fund agreement says that a country may not control current transactions except with the approval of the Fund, but that it may control capital transactions as it pleases, and then it gives the case where a country having made great use of the Fund resources may be requested by the Fund,

Now, a floating rate is neutral on the current account side of the balance of payments. It does not intensify your recession, but it does not alleviate it. As between having a neutral policy and one which aims to give you more employment in a recession and to help undo the effects of full employment in a boom, I would rather have the counter-cyclical type of behavior. This is apart from the fact that a floating rate tends to exaggerate the cyclical movements in prices.

CONGRESSWOMAN MAGNUSON: I follow you on exposition of the distinction between the operation of the Gold standard and the operation of the International Monetary Fund rules. Does not the granting of the Monetary Fund, in some degree, contemplate the control of capital movements in the sense that with control of capital movements there is an opportunity to commit it there in a fundamental disequilibrium? If your capital rushes in confidently, you get a tremendous disequilibrium there, and you not likely to have a fairly reasonable alternative?

MR. BERNSTEIN: It is here that when the Bretton Woods proposal was first discussed some people objected that the Fund was designed to control capital movements. The Fund agreement says that a country may not control current transactions except with the approval of the Fund, but there it may control capital transactions as it pleases, and when it gives the case where a country having made great use of

as a condition of further use of fund resources, to control capital movements. I do not know of any case where the fund has actually asked anyone to do that.

It is true, that with convertible currencies and freedom of exchange transactions it is very difficult to avoid capital movements. I think it is probably true that if a country lets its balance of payments drift away from the proper position, the world may come to the conclusion that the balance of payments is seriously out of order, and that the country does not have the capacity to restore it. There may then be some very large capital movements. But if the monetary authorities are alert to the problem, they will be aware of the need to take remedial measures long before the rest of the world. I do not think we need be nearly so concerned about the possibility that with fixed exchange rates there will be massive capital movements when the balance of payments is weak. It has been my opinion for a long time that there can be massive exchange movements with floating exchange rates too.

COMMISSIONER MACKINTOSH: In fact, how many countries in the world do not permit completely free capital movements?

MR. BERNSTEIN: Do you mean for their own nationals or for non-residents? One must make a distinction. In the great trading countries non-residents are practically free to move their funds as they wish. On the other hand, residents are not free to do so in some countries. In the United Kingdom,

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MR. [illegible]: Do you mean for their own nationals or for non-residents? One must [illegible] distinction. In the great trading countries non-residents are practically free to move their funds [illegible] very much. On the other hand, residents do not

because of the great discipline of the people, unauthorized capital movements to countries not in the sterling area are probably not large. But there is some unauthorized movement of funds out of the United Kingdom. Non-sterling area residents are completely free to move their liquid funds out of the United Kingdom. Investments in securities can be transferred only through security sterling, although this is not a serious limitation.

COMMISSIONER MACKINTOSH: Over the last two days both Dr. Holtrop and Professor Lundberg explained the situation in Holland and Sweden. Apparently those countries exercise considerable control over the movement of funds by their residents, although Sweden and the Netherlands do permit quite large movements of short-term funds.

MR. BERNSTEIN: I think, Dr. Mackintosh, that the United States may sometime find it helpful to exercise moral suasion on some types of capital movements. Anybody that wants to move capital would be completely free to move it. But I see no reason why the Federal Reserve Bank of New York should not say to the New York banks: "Do you not think your foreign lending is a bit high in view of the balance of payments?", just as they may now say: "Do you not think your lending is too high in view of the state of the domestic economy?" The same would be true of the investment banks. I can see no reason why the Federal Reserve Bank of New York, without applying any law, could not say to the investment banks:

pressure of the vast majority of the people.

Nevertheless, capital movements to countries not in the sterling area are probably not large. But there is some unauthorized movement of funds out of the United Kingdom. Non-sterling area residents are completely free to move their capital out of the United Kingdom. Investments in securities can be bought and only through currency sterling. Although this is not a foolproof control.

[illegible] IMPORTANT. Over the last [illegible] to date, Sterling area Prohibited [illegible] maintained the structure by inflation and threat. [illegible] there considerable exercise [illegible] control over the movement of funds by [illegible] although Sweden and the Netherlands do permit quite large [illegible] of short term funds.

MR. GERHARDSEN: I think, Mr. Secretary, that the United States may [illegible] to [illegible] to [illegible] movements. Anybody must wants to move capital would be completely free to move it. But I see no reason why the Federal Reserve Bank of New York should not [illegible] the New York Times: "Do you not think there is leading to a belief to view of the balance of payments". Just an hour ago: "Do you re[illegible] your lending to the rest of the [illegible] value of the investment pound." It was made clear to the Federal Reserve Bank of New York without [illegible] any law, could it be [illegible]

"We know there is a lot of profit in this foreign issue, but do you not think it would be better to put it off until another time when the balance of payments is stronger?"

COMMISSIONER MACKINTOSH: Do you not think they would reply in the way Vanderbilt, I think it was, replied: "6 per cent talks louder than 4 per cent".

MR. BERNSTEIN: I think they would give a soft answer, although they might not change their practice. As a matter of fact, I think they would be susceptible to the proposition that the public interest in a question like this must be given great consideration.

We are not at that stage. I do not see this as a question of capital control. I see this as a use of the instrument of moral suasion in the field of foreign exchange policy, particularly as it refers to capital flow, in the same way as I look at moral suasion on the domestic credit side. I do not see anything wrong in the monetary authorities indicating that in their judgment capital outflow or inflow is too big or too small. There is nothing wrong in that. It is an expression of an official view of the behaviour of the economy, and the desirability of people adjusting individual behaviour to what would in the long run be more desirable for the economy as a whole.

COMMISSIONER MACKINTOSH: We get in our evidence quite a strong reaction against moral suasion

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this as a question of capital control. I see this
as a use of the instrument of moral suasion in

from both Canadian and American witnesses, who say: "Set the rules and conditions, and let the market operate."

MR. BERNSTEIN: I am not really very much inclined to it myself. I was just saying that there is nothing wrong in it. I think on the whole the trouble with moral suasion, as with many other things, is that the incidence is so uneven. The thin-skinned fellow is easily persuaded, and the thick-skinned fellow goes right ahead with what he is doing.

COMMISSIONER MACKINTOSH: In your section on foreign exchange policy you give a very clear exposition of what you think an appropriate balance of payments is. There is rather less explanation of the problems involved in changing from one appropriate balance of payments to one which has now become appropriate.

MR. BERNSTEIN: There are two different aspects of the balance of payments. Suppose that over-all payments on current and capital account are in balance in the year 1956. Now in 1962, the over-all balance of payments may show a surplus or deficit on current and capital account.

The second problem may be different. You may have a balance of payments which is appropriate for the year 1956 in which the current account deficit is, say, $800 million, and the net capital inflow is also $800 million. In 1962 you may think that the economy requires a different structure in the balance of payments; that you require an appropriate

"But the rules are complicated, and let the market operate."

MS. DESHOWITZ: I am not really very much inclined to it myself. I was just asking what there is wrong with it. I think on the whole one should be most reluctant, as with any other fiscal, to put the burden in no manner. The chip-already yellow is small, permanent, and the white-rimmed fellow [sic] small [sic] when [illegible].

COMMISSIONER MCDONOUGH: In your section on foreign exchange policy, you give a very clear exposition of what you think an appropriate balance of payments is. There is however considerable controversy in the [illegible] from one economist to another as to the balance of payments. Suppose that in 1965 the over-all payments on current [illegible] account are in balance in the year 1966. Not in 1967, the over-all balance of payments may show a surplus or deficit on current and capital account.

The second problem may be different. You may have a balance of payments which is appropriate for the year 1967 in which the current account [illegible] is, say, $800 million, and the net capital [illegible] is also $800 million. In 1968 you may find that the country [illegible] a different [illegible]

balance of payments in the sense that payments and receipts balance with a smaller capital inflow.

Both of these, in a sense, are problems. The second is not so much a balance of payments problem as an economic problem. You meant the first one, did you not, Dr. Mackintosh -- you meant moving from an over-all surplus to a deficit and then back to an over-all surplus?

COMMISSIONER MACKINTOSH: Yes, but I would think the two are not so distinct. I think where you have changes from one set of circumstances to another you will always have structural difficulties because your structure is likely to be appropriate to the former set of circumstances and lag a bit. I must say that I am a little distrustful of putting things on structural difficulties. It is real enough, but all changes involve structural difficulties.

MR. BERNSTEIN: Yes, sir, but I was thinking that the structural difficulties are much greater in the one case than in the other. I do not think we want to get rid of this problem by giving it a name. I would rather discuss the question.

COMMISSIONER MACKINTOSH: Yes.

MR. BERNSTEIN: If a country like the United States has a balance of payments deficit which originated from the fact that the growth in its exports has been a little bit less than the growth of its imports, then the problem of change is going to be a relatively minor one. It can be overcome in the course of three or four years because what is required is a holding

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MR. BERGSTEN: If a country like the
United States has a balance of payments deficit that
is eliminated from the fact that the growth in the capacity
for trade is little bit less than the growth of the import
when the problem of change is found to be a relative by
either one. It can be overcome in the course of time

down of our costs relative to those of the United Kingdom, Germany and Canada who are all competitors. In the course of three or four years we may with a little more cautious credit policy and budget policy restore our competitive position.

When you want to change from a balanced payments position with a current account deficit of $800 million and a capital inflow of $800 million to one of a deficit current account of $400 million with a similar capital inflow, you are not trying to restore a previous level of exports by a small change in relative prices; you are trying to move on a large scale permanently to a new relationship of exports to imports and of home savings to investment. I suppose the real answer is that with respect to one of these problems you are going to adjust in two or three years, and for the other one you may take ten or fifteen years.

One balance of payments problem you have to correct rather quickly, and the problem of adjustment need not be very difficult. The other one involves a great change in your domestic economy, but a change that you can undertake in a gradual way by adjusting monetary and economic policies of a more far-reaching character. This is why the second type of payments problem will be a longer range problem and probably a more difficult one.

COMMISSIONER MACKINTOSH: And you imply that the appropriate monetary and fiscal policy in the second case would be a mildly restrictive policy?

MR. BERNSTEIN: It is not merely restrictive; it is more complex than that. When you want to change the structure of the balance of payments to reduce dependence on capital inflow,you do have to hold back the increase in wages relative to productivity and you may have to do that for some time. But you must take other measures to increase domestic saving and to discourage borrowing abroad.

To improve the over-all balance of payments you hold back the rise in wages and increase interest rates. To change the structure of the balance of payments, with more exports and less capital inflow, it is necessary to hold back the increase in wages to encourage exports. But it is also necessary to hold down consumption through taxes and a budget surplus and to ease credit with lower interest rates to encourage borrowing at home. The two policies will not be exactly the same.

COMMISSIONER LEMAN: Mr. Bernstein, before Dr. Mackintosh leaves this subject may I say that you refer quite often in your notes to being able to keep that relationship, or trying to bring about that relationship between the rise in wage rates and the increase in productivity. I am wondering if the measurements are quite as easy as you make them sound.

MR. BERNSTEIN: No, sir, they are so hard that I do not bother measuring them at all. Instead I use what might be called objective indications. It is hard to go about measuring the rate of increase in productivity, even if we could define it, and also the rate of increase in wages, if we could define that.

MR. MCINTOSH: It is not merely qualitative it is more complex than that. When you want to change the structure of the balance of payments to reduce dependence on capital inflow, you do have to hold back the increase in wages relative to productivity and you may have to do that for some time. You also must take other measures to increase domestic saving and to discourage borrowing abroad.

To improve the over-all balance of payments you hold back the rise in wages and increase interest rates. To change the structure of the balance of payments, with more exports and less capital inflow, it is necessary to hold back the increase in wages to encourage exports. But it is also necessary to hold down consumption through taxes and a budget surplus and to save credit with lower interest rates to encourage borrowing at home. The two policies will not be exactly the same.

COMMISSIONER LEMAN: Mr. Bertrand, before Dr. Macintosh leaves this subject can I not just refer quite often in your notes to being able to vary their elasticity, or trying to bring about a relationship between the rise in wage rates and the increase in productivity. I am wondering if the measurements are quite as easy as you make them seem.

MR. BERTRAND: No, sir, they are not as hard that I do not foresee measuring them at all. Indeed I use what might be called objective indications. It is hard to pin down measuring the rate of increase in productivity, even if we could define it, and it

It is not very difficult to define a rate of increase of wages in any industry, but it is very hard to define the increase in wage rates in an economy, so I do not use that. I do not measure them. I do it qualitatively.

Suppose exports have been falling steadily relative to imports and that this is not due to excessive aggregate demand because this is a normal amount of unemployment: there may be special reasons why exports are falling steadily relative to imports; but if there are no special reasons, then we must [illegible] with the presumption that one of two things has happened. Either a country has permitted its competitive position to become adverse, or reciprocal demand for exports and imports has changed. If prices have risen too much, relative to those of other countries, then the competitive position has deteriorated. If that has not happened, then we must conclude that relative demand for exports and imports has changed. But we do not actually have to have a precise diagnosis because the remedy is going to be the same, and that is to slow down the rise in wages.

Now, the question is: How to [illegible] the rise in wages? There are only two ways in which a country can slow down the rise in wages. One way is to make the inducement to hold out for wage increases a little bit less than it was before, and that means there must be a little more pressure on the export and import competing industries through unemployment. That does not require widespread unemployment, [illegible]

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a little ... long run it ... before, ... [illegible]
... just be a bit to more ... [illegible]
import competing ... [illegible]

labour in the export and import competing industries to feel the pressure for jobs and adjust their bargaining for wages to that.

The other way would be for the government, in one form or another, to exercise some kind of influence on the willingness of workers to bargain for wages and businessmen to consent to wage increases, so that there will not be excesses.

When we see the balance of payments on current account deteriorating, and a substantial deficit continuing for two or three years, without having specific reasons for the decrease in exports relative to imports, then we know that either the competitive position has deteriorated or the reciprocal demand has changed adversely. It may be that the Europeans or Japanese are supplying more of a country's export goods than they did before. We can try to determine the causes by looking around, but I do not think we can precisely measure them. We only approach the proper solution slowly. We hold wages down for a year or two. We are not trying to prevent a rise in wages in a country with increasing productivity, but we would like it to be a little more moderate. If we find improvement after a year or two, the wage rise can be resumed at the normal rate. This is a method of approximation.

COMMISSIONER MACKINTOSH: You do not favour them taking a figure for annual increase in the money supply and sticking to it?

MR. BERNSTEIN: I do not believe , Dr. Mackintosh ,

to feel the pressure for jobs and adjust wholly
guaranteeing for wages to that.

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CHAIRMAN MARTINSON: I do not [illegible]
when making a figure for normal [illegible]
supply and relating to it
[illegible]: I do not [illegible]

that it is possible to achieve, year after year, or even averaging over a few years in a longer period, an annual average increase in the money supply roughly equal to the increase in, say, the Gross National Product. The monetary authorities cannot achieve it because the public's preference for liquidity, for assets in other forms, will be changing in this period. People have been criticizing the Federal Reserve because the increase in the money supply has been negligible over the past two years. But as the Federal Reserve kept pouring more funds into the monetary system the public decided they wanted to put these funds into savings or time deposits, and much of the funds that did not go into such deposits went into liquid assets abroad. The result of the effort to get more cash balances in the hands of the public -- an increase in the money supply -- was to get a slightly larger capital outflow and a much larger increase in savings deposits. If the U.S. monetary authorities try to increase the money supply much more, they are going to find that, in fact, they will have very little effect. I cannot see any good reason for making a specified increase in the money supply, the objective of monetary policy at this time.

The real question is whether any business prepared to employ labour is unable to do so merely because credit is not available? If there is such a business or firm in the United States, we want to find out why they cannot get the money to employ labour now. I am not concerned with whether the money supply is

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the Federal Reserve keeps pumping more funds into the
system the public decides they wanted to put those funds
into savings or time deposits, and so the first
effect can not be long sustained, and could be very
great shock. The result of this action by the
Bank authorities is the desire of the public -- as funds
in the money supply -- the to get a relatively larger
portion of the U.S. monetary supply -- to
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a little less or a little more over a short period. For a longer period the money supply cannot grow significantly less than the Gross National Product without forcing on the economy a higher interest rate.

Under present circumstances U.S. interest rates are sufficiently attractive, low as they are, to induce an adjustment of money supply to interest rates in the short run. If the monetary authorities try to increase the money supply much more, people will use the funds to increase savings deposits, not cash. In the long run, if we fail to get an adequate increase in the money supply it will be a sign that monetary policy is not suited to the needs of the economy, and it will bring increased interest rates. I would not make the short run behaviour of the money supply a significant test of good policy.

THE CHAIRMAN: I want to go back for a moment to what you said about the structural adjustment that would be necessary eventually to solve the balance of payments problem. As I understood it, I think that applies to this country. You mentioned a lower interest rate as one necessary step. Am I right about that?

MR. BERNSTEIN: Yes, sir.

THE CHAIRMAN: Over a long or considerable period?

MR. BERNSTEIN: Yes.

THE CHAIRMAN: I was not quite sure whether your remarks a little later, about wage increases,

a little less or a little more over a short period.

For a longer period the money supply cannot [illegible] significantly less than the Gross National Product without forcing on the economy a higher interest rate.

Under present circumstances U.S. interest rates are sufficiently attractive, for as they rise, to induce an adjustment of money supply to interest rates in the short run. If the monetary authority may to increase the money supply much more, it will use the funds to increase savings deposits, not cash. In the long run, if we fail to get an adequate increase in the money supply [illegible] that monetary policy is not suited to the needs of the economy, and it will bring increased interest rates. I would not make the short run relationship of the money supply a significant test of good

THE CHAIRMAN: I want to go back for a moment to what you said about the relationship between ment that would be necessary eventually to solve the issue of payments problem. As I understood it, I think that applies to this country. You mentioned a longer measured rate as one [illegible] right about that?

MR. SHEPHERD: Yes, sir.

THE CHAIRMAN: Over a long or general trend

MR. [illegible]: Yes.

THE CHAIRMAN: I was not [illegible]

applied to this particular situation.

MR. BERNSTEIN: Yes.

THE CHAIRMAN: They did?

MR. BERNSTEIN: Let me put it this way, Mr. Chairman, a country like Canada has high wages essentially because it is very productive. These wage rates at the margin are slightly affected by the capital inflow. A big capital inflow means that real wages in Canada are a little bit higher than they would otherwise be.

The relationship is not as complicated as it might seem. Prices in Canada must be related to wage rates in Canada, but those prices and wage rates, in terms of Canadian dollars, can be a little higher with capital inflow than without it, so imported goods purchased by labour are cheaper than they would otherwise be. That is the whole of the gain in real wages that wage earners get through the process of a larger capital inflow. This is taking the indirect effect of capital inflow on the rate of investment and productivity of labour in the future.

If there is to be a smaller capital inflow over the next ten or fifteen years, this means that Canadian wage rates, in terms of Canadian dollars, instead of rising, say, 3 per cent per year may have to rise 2.8 per cent per year on an average. Or, if there is a bigger increase in productivity than that, it may be a 3 per cent increase in wages a year because productivity is going up, say, by 3.2 per cent a year. The cumulative effect of this over a period of ten or

applies to this particular situation.

MR. WARBURTON: Yes.

MR. GUGGENHEIM: Let me put it this way, Mr. Chairman, a country like Canada has built wages essentially because it is very productive. Those wages cannot be the margin are slightly affected by the applied tariff. A big organized industry whose wages in Canada are a little bit higher than they would otherwise be.

The relationship is not as complicated as it might seem. Tariffs in Canada must be related to wages in Canada, but those duties are wage increases, in terms of Canadian dollars, can be a little higher with applied tariff than without it, as I mentioned before. What is the whole of the gain in real wages that wage earners get through the purchase of a larger capital inflow. This is taking the industry, or capital inflow on the basis of increases, etc. [illegible] of labour in the future.

If there is to be a smaller capital inflow over the next ten or fifteen years, this means that Canadian wages, in terms of Canadian dollars, increased at rates, say 3 per cent per year may rise to rise 2.3 per cent per year or an average. Or, if there is a greater increase in productivity than 3%, It may be a 3 per cent increase in wages a year, reasonably is going up, say 2.3 per cent.

fifteen years will be sufficient to make it possible for Canada to increase its exports relative to its imports by just as much as you want to decrease the capital inflow. Simultaneously, the interest rates will be moving down in Canada, to induce some shift to domestic finance instead of foreign finance. I do not want to exaggerate the effect of this on every type of foreign investment. There would be some foreign investment that would be sensitive to the interest rate. It is not a process that involves any real pressure on the standard of living. It is a gradual adjustment, in which a rising standard of living is accompanied by a change in the relationshp of wages to productivity and of interest rates to domestic savings. That is all.

THE CHAIRMAN: Those are the only two important factors?

MR. BERNSTEIN: I would put it this way --

THE CHAIRMAN: I was just wondering whether there are any other techniques or any other additional methods that could be introduced?

MR. BERNSTEIN: Of course, you must use fiscal policy along with this too. You must hold down the consumption of the community by a certain fiscal policy. The government will have to collect more in taxes than it spends on public expenditure, and because of the budget surplus there would be an increase in the supply of savings in the community. This would permit lower interest rates because you would be able to satisfy the domestic demand for capital more out of domestic

savings. You would have to find a way of pushing up your exports relative to your imports; but fiscal policy will have some direct effect on that too, because whatever taxes you have designed to cut consumption relative to investment will be cutting the import of consumer goods. That is not the whole of the story, because when you are all through making the adjustments of consumption and investment and wages and interest rates relative to productivity in the Canadian economy, you want to be sure there is enough enterprise, enough technology and enough real capital to go ahead and provide that level of investment which Canada needs for economic progress. Nothing is gained by keeping out investment because it is foreign, unless you simultaneously increase saving and investment by Canadians. So you have to have a corresponding change on the real side to match these monetary changes.

THE CHAIRMAN: Then the whole process would be a gradual one?

MR. BERNSTEIN: Yes, it has to be.

THE CHAIRMAN: There would be no sudden cutting off of foreign investment?

MR. BERNSTEIN: It would be madness to cut off a limb of a tree which is healthy and helpful merely because you want the tree to grow in another direction, before you are sure you have the sunshine to get it to grow in that way.

COMMISSIONER HARROLD: You have to match wages and productivity.

Mr. Bernstein, you said it was very difficult to measure productivity, and yet in one or two places you have measured in terms of productivity. On page 3 you speak of "the high output sectors" and "the low output sectors". I am interested in how you arrived at the general definition.

MR. BERNSTEIN: These are works of art. I had a colleague named Walter Gardner, who was once on the Federal Reserve Board, and I brought him to the International Monetary Fund. He was a great classicist and would not use any terms that could not be found in classical economics. He would talk about the rise of wages in coal mining matching an increase in productivity even if wages and prices both went up in coal mining. I do not like to use the term "productivity" to differentiate between high output areas and low output areas. A high output sector is a sector in which the money value of the output is very high relative to labour. That means that wages will be high and, perhaps, that profits will be high.

In the United States and Canada the high output sectors are durable goods industries and construction, and the low output sectors are agriculture and some services. That is to say, the return to the community, in terms of U.S. or Canadian dollars, for the worker employed in agriculture is much less than for industry. Strangely, the increase in physical productivity per worker in agriculture is much greater between 1938 and the present than the increase in productivity in manufacturing. Nevertheless, if

Mr. Samuelson, you said it was very difficult to measure productivity, and yet in one or two places you have measured in terms of productivity. On page 3 you speak of "the high output sectors" and "the low output sectors". I am interested in how you arrived at the general definition.

Mr. BUCHWALD. There are no ifs or buts. I had a colleague named Walter Gardner, who was once on the Federal Reserve Board, and I brought him to the International Monetary Fund. He was a great originality and would not use any terms that could not be found in conventional economics. He would only speak, he ria. of wages in real sterling measuring ca Increase in productivity even if wages and prices went up in real sterling. I do not like to use the term "productivity" to differentiate between high output and low output areas. A high output sector is one, in which the money value of the output is very high relative to labour. Then more than wages will be high and, perhaps, then profits will be high.

In the United States and Canada the high output sectors are durable goods manufacture and construction, and the low output sectors are agriculture and some services. That is to say the return to the community, in terms of U.S. or Canadian dollars, for the worker employed in agriculture is much less than for industry. Similarly, the increase in material procurement per worker in agriculture is much greater between 1961 and the present than the increase in

you had shifted a man from agriculture to manufacturing, the community's productivity, as some people measure it, would have gone up. That is because they measure productivity by taking the value of the output per worker at constant prices. Then if more workers are employed in the high output sectors, like automobiles or construction, this means that productivity has gone up. This is a different concept from a technological increase in productivity.

A good deal of the increase in productivity per worker in Canada and the United States, between 1938 and 1956 or between 1946 and 1956, was the result of the shift in the proportion of the working force engaged in the high wage employment sectors. There was more and more shifting, year after year, to the high income sectors, and away from the low income sectors.

Since 1956, productivity happens not to have risen so much, but that is because the high wage employment sectors have not been growing relatively as much as the rest of the economy.

Even with full employment Canada would have had a lower rate of growth from 1956 to 1962 because the output of automobiles, residential construction, plant and equipment -- your high output sectors -- did not increase total output as much as the non-durable manufacturing industries and service industries. I prefer the term "high output" to "high productivity" to describe this.

COMMISSIONER HARROLD: It seems to me that a country with the percentage engaged in a sector

such as agriculture being reduced, and the output of agriculture being increased -- as in United States and Canada -- with the percentage being reduced to 10 per cent of the population, that sector must have a fairly high output?

MR. BERNSTEIN: Yes, if we take "productivity" technically -- that is, output of bushels per man-hour of work, or per dollar invested in equipment -- then by all these tests the output in Canadian and United States agriculture has risen fantastically from 1938 to the present period. On the other hand, it still remains true that if this man had been moved -- that is, a group of workers had been moved out of agriculture into, say, construction, and if you could have kept them employed in construction, the value of their output would have been much greater, even though efficiency had not increased as much in construction as in agriculture. The increase in the aggregate output of the community would have been larger.

I can give you a case where wage rates remain absolutely the same and average wages rise. It is very simple. If you have two industries, one at $1 and one at$2 an hour and they each employ ten workers,their average wages will be $1.50 an hour. If the structure of the economy changes with five workers at $1 an hour and fiften at $2 an hour average wages will be $1.75 an hour. This is involved in measurements of growth and productivity. It causes a lot of confusion in discussions of how efficient

the economy is.

A good deal of the increase in European productivity, compared to ours, is the consequence of the fact that they are still moving more and more of their labour to the high output industries. As they do this they approach our pattern of production and consumption, and their output seems to be rising faster because ours is no longer moving in that direction. In the United Kingdom expenditures on consumer durable goods is two-thirds of what it is in Canada and the United States, and on the continent of Europe it is even less. As their consumption and production move in this direction, and we no longer want to increase the proportion of our expenditure in the form of consumer durable goods, their output seems to grow faster than ours. If we could measure the technical increase in productivity, industry by industry, I do not think you would find their growth in productivity much greater than ours, although still somewhat greater in the past six years.

THE CHAIRMAN: You mentioned earlier there was a differential between the machine-producing industries and the machine-using industries. Machine-using industries generally represent a lesser wage rate and a good deal has been raised, especially yesterday by Professor Lundberg, about movements from the lower wage industries into the higher wage industries, and that was one of the great purposes of their method of doing things. Well, once all the machine-using workers become absorbed in the machine-manufacturing

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THE CHAIRMAN: You mentioned earlier there
was a difference between the machine-producing industries
and the consumer-goods industries. Members seem
frequently to express a fear as to the
a good deal has been made, especially yesterday,
by Professor Lamontagne, as to movement from the
lower wage industries into the higher wage industries,
and that was one of the great purposes of their method
of doing things. Well, once all the equipment

industries, there wouldn't be anybody to buy the machines, would there?

MR. BERNSTEIN: Well no sir, I don't think that last conclusion, Mr. Chairman, is correct. There would be nobody to work with the machines, but then the question is do we have to have a worker work with the machine at all?

THE CHAIRMAN: If you have a machine, I suppose it is strictly autonomous.

MR. BERNSTEIN: This, Mr. Chairman, is an exercise in pure logic, but I do want to get to the merits of your point.

It is absolutely correct that countries like ourselves and Europeans really must move much more to the high output industries and stop depending too much on producing the low output goods by keeping out the Hong Kong, the Indian and the Japanese producers of these goods on the grounds that their wages are too low.

This is not new; we ought to have known this a long time ago. In 1945, at the time of the British loan, I wrote a paper published in the American Economic Review entitled British Policy and a World Economy in which I argued strenuously that the United Kingdom must stop depending on exports of textiles and coal and get on to producing more of the high output goods and sell them to the world. The high income countries could produce more machines and sell them abroad on a large scale if they were content to take in exchange the goods produced by the low income

countries.

Apart from that, we could absorb more machines in our own economy, as we do in fact. Sometimes the point is made that technological advances in the manufacturing industries are so rapid that the annual increase in output the community is willing to absorb can be achieved without any increase in the labour force in manufacturing. And the answer, Mr. Chairman, is that we certainly can have that.

What is more, in the United States the increase in manufacturing output has been going on for years without any increase in the machine-workers -- I mean, the workers using machines, what we call production workers in factories. The numbers employed in production work in manufacturing are smaller than they were some years ago, and in such an economy we must make sure that other avenues of the economy are growing enough to provide the employment the community needs. An easy brushing off of the problem of increased technological advance on the grounds that the machine-makers always create more jobs than the jobs they displace is not realistic. It could be true, but it needn't be true, and as a practical matter in the United States it hasn't been true over the past few years. With increased demand for output of manufacturing goods in the United States and a smaller number of production workers employed to produce these goods, there could be a difficult employment problem if simultaneously the economy were not expanding to meet this development.

COMMISSIONER MACKINTOSH: To turn back to the foreign exchange policy as you have expounded it, I don't want to repeat or go over ground you have already covered, but as I understand it you recognize there may be a conflict in the choice of appropriate interest rates as between the external and the internal requirements, but that your position is that the conflict is reduced greatly if the movement of interest rates is kept within a moderate band, excluding both very low and very high rates, is that so?

MR. BERNSTEIN: Yes, but I add another point to that, too, that the adverse effects are further limited if you have a system under which resources are available to meet the temporary outflow of short-term funds. That is precisely why I think the International Monetary Fund set up this special fund of $6,000 million, to which ten countries, including Canada, contributed, and on which these countries will be able to draw primarily to meet capital outflow.

COMMISSIONER MACKINTOSH: You have a later section on international co-operation on capital movements. Would you care to expand that a bit in more explicit terms as to the kind of arrangements you contemplate?

MR. BERNSTEIN: Well, I would say that the history of international financial operations can be divided into four segments over a long period of history.

There was one period in which there was no

COMMISSIONER MACKINTOSH: It's time back to the formal meeting policy as you have expounded it. I don't want to repeat or go over ground you have already covered, but as I understand it you recognize there may be a conflict in the case of economists interest rates as between the external and the internal requirements, but make your practice is that the conflict is resolved generally in the favour of interest rates as kept within a moderate rate, something both very low and very high rates, is that not?

MR. DUNCAN: Yes, but I can add one point to that, too, that the adverse effects are further limited if you have a situation such that resources are available to meet the temporary outflow of short-term funds. That is precisely why I think the International Monetary Fund set up this special fund of $6,000 million, to which ten countries, including Canada, contributed, and on which those or others will be able to draw promptly to meet capital outflow

COMMISSIONER MACKINTOSH: You have a labor booklet on International co-operation on capital movements. Would you care to say who that's put out by, as to the kind of group, somewhat more explicit terms as to the kind of group, somewhat your conclusions?

MR. DUNCAN: Well, I would say that the history of international financial co-operation has developed since Bretton Woods over a very broad front

co-operation because everybody was satisfied that the gold standard provided, so to speak, automatic and supreme international co-operation on monetary and financial questions.

There was a period from 1930 for a few years when we might say that countries were destroying each other's monetary system by forcing an excessive depreciation. This may have been inevitable, incidentally, because the gold bloc countries, by continuing deflation, were causing a lot of trouble to themselves and the rest of the world. Then we come to Bretton Woods. From Bretton Woods to 1959 we had reasonably close international co-operation, with the better working of the Fund and the creation of the European Payments Union as well as co-operation in other ways. I would say that from 1959 or 1960 to the present we have had a new era in the field of international financial co-operation. It seems to me ---

COMMISSIONER MACKINTOSH: Did you say from 1959?

MR. BERNSTEIN: Yes, to the present. In the last three years a consensus has emerged in the international financial world -- including the treasuries as well as the central banks -- a consensus on the kind of policies that must be followed and the support they must give each other in achieving these policies.

Let me give you some idea what I have in mind. The most important single step is, of course, the very large special fund of $6 billion to finance

capital movements created by ten countries to protect the United States and the United Kingdom primarily, but also these other countries which are financial centres. This is an enormous achievement. On top of that we have the collaboration of the central banks on the London gold market. When you compare the attitude that the U.S. Treasury took on the London gold market, in 1960 with the attitude today, you see the great difference of the past two years. Now the United States recognizes the danger of allowing the market to get out of hand and generate flight from the dollar to gold. Remember that the dollar competes with gold as the prime hoarding instrument of the world. These are the two big hoarding instruments of the world. I am not talking about Americans and Canadians, I am talking about people elsewhere. Is it not to the advantage of the United States and the rest of the world for people to get the notion that gold is a better hoarding instrument than the dollar. A rise in the price of gold may not reduce hoarding but increase it. Although at $37 an ounce people ought to buy less gold, the philosophy seems to be that if it has risen from $35 to $37 an ounce, we had better buy gold now before it rises more.

The United States took the attitude when the first big movement of the gold market in London occurred that if speculators pay $37 an ounce, they will be burned and they won't try it again. Of course, this could happen. The speculators have limited sums, and when the price falls back to $35

an ounce these speculators will have lost money. But, we must always bear in mind that if gold goes to $37 an ounce, new layers of demand may be coming forth, and we may have a serious problem on our hands. The Bank of England convinced the U.S. Treasury that it would be wiser to manage the price of gold in London and make sure it doesn't get out of hand. Now, the United States and the European banks co-operate by feeding gold into the London market at the range of $35.13 to around $35.20 an ounce. These figures have a certain meaning on a proper relationship between the U.S. official price of gold and the price in London. I think it has had a salutary effect and I think that the diversion of gold into hoards is not greater because of the support of the London gold market.

Further, the United States for the first time in a generation is operating in the exchange market. The United States used to operate in the exchange market in the 1930's, but stopped about the time the war broke out. The United States did not seem to recognize that the Gold Reserve Act of 1934 really had banished the U.S. Treasury to the very fringe of the world gold markets and that it had better come into the exchange market if it wanted to affect exchange rates before they moved to the gold points.

Fortunately some of the wise young men that have joined the Treasury have recognized that one of the best ways of avoiding a big outflow of short-term

funds from the United States is to lessen the inducement to do so for interest arbitrage. If the yield on Treasury bills in London is, say, 2 per cent higher than on treasury bills in New York, people can convert dollars into sterling and buy U.K. Treasury bills and get a forward contract for dollars in terms of sterling at less than that 2 per cent per year difference. Incidentally, covered interest arbitrage is self limiting, because as people buy spot sterling to invest they force up the rate of sterling, and as they try to buy forward dollars to cover their position, they force up the premium on forward dollars until the profit disappears. The Treasury can stop this process earlier by intervening directly in the exchange market, and terminate the inducement to transfer dollars for covered interest arbitrage.

COMMISSIONER MACKINTOSH: This is by operating on the forward rate?

MR. BERNSTEIN: Yes, relative to the spot rate. The United States made arrangements with a number of central banks -- first, the U.S. Treasury, and now the Federal Reserve Bank of New York -- to make their currencies available to the United States for such operations without selling gold. This seems to me an enormous change. Through swaps and stand-by credits, the United States has about $900 million of liquid resources it can use in the exchange market in this way.

I would say the third step is the co-operation

on short-term interest rates with the Organization for Economic Co-operation and Development. In my opinion, the days of 7 per cent bank rate in London are over, just as the days of the one per cent U.S. Treasury Bill rate or the one-half to one and a half per cent discount rates at the Federal Reserve banks are over. We are going to have co-operation in interest rates so that while they will be as far as possible suited to the needs of a country for its domestic economic purposes, they will not be so out of line relative to those of other countries as to generate large capital movements.

Now, Professor Holtrop, has proposed that much the same thing be done with long-term interest rates. This is a much more difficult problem, as central banks don't have as much influence over long-term rates as over short-term rates.

Finally, I would say we are about to move into another important field. I don't know how long it will take to achieve, but I believe that we are going to have new co-operation on a more rational system of using the International Monetary Fund as a part of the world's reserves.

I would say, Dr. Mackintosh, that what has happened in the last three years is almost a revolution. It could only happen because there is not a responsible central bank or government in the world that is not ready and eager to co-operate in order to avoid crises. If we can avoid crises of confidence on the dollar and other currencies we shall see a satisfactory

development of the world economy, without distortion in payments and without depression. What we have to fight is the fear that the dollar or sterling will go under. Central banks recognize it and they are co-operating more closely than ever before.

COMMISSIONER LEMAN: What will be the weapon? Will it be access to the services of the International Monetary Fund to keep countries behaving as they should behave? Will the penalties be loss of access ---

MR. BERNSTEIN: I am not very much in favour of disciplining a country by denying it access to reserves. I do not think you gain very much by saying to a country in trouble: "We are going to bring you to the brink of disaster." I do not think that will help the situation very much. We must persuade countries that sound financial policies are in their own interest. This is hard, but it will be done.

COMMISSIONER GIBSON: May I interject a question here? You have described this very interesting arrangement with regard to operations in the futures exchange market. Do I understand you to say that a number of central banks were supporting the funds ---

MR. BERNSTEIN: Supplying funds.

COMMISSIONER GIBSON: --- of another central bank in order to enable it to carry out its operation?

MR. BERNSTEIN: Yes. They are financial swaps. Here are the swaps that have been arranged. In October, 1961, with the Swiss government, $46 million

January, 1962, with the Italian government, $25 million; March, 1962, with the Italian government, $50 million. Some of these have not been swaps.

COMMISSIONER GIBSON: Each one of these is a separate transaction agreed upon between the Federal Reserve Bank of New York and the foreign bank?

MR. BERNSTEIN: Yes, sir.

COMMISSIONER GIBSON: They do not have a fund?

MR. BERNSTEIN: No, and I do not say that other countries could all make similar arrangements, although many could. In the late 1930's, when the United States and the United Kingdom co-operated in support operations in the exchange market, the Bank of England had to settle at the end of the day in gold. Here you have arrangements running to large amounts of credit, and the arrangements running for months.

COMMISSIONER GIBSON: I understand some central bankers are dubious about operating in the futures market. Have you any comments on that?

MR. BERNSTEIN: If you have a big capital outflow it is certainly sensible to limit it by making the cost of covered interest arbitrage high enough to induce a halt in the outflow of capital. The impact this has on the forward market is not going to disturb trade relationships. I do not think the effect on an exporter or an importer of a change of a quarter cent in the premium or discount in the forward

exchange market for sterling will in any way hamper imports or exports. I do not think the United States Treasury has acted in the forward exchange market, except for the purpose of limiting the flow of funds for interest arbitrage.

COMMISSIONER LEMAN: Mr. Bernstein, with respect to what you have explained to us about the possibility and the desirability of limiting these changes in short-term interest rates through monetary action in each country, is it partly or largely because this world now is not in an inflationary situation that this is now possible?

MR. BERNSTEIN: That is right. It is a little more complicated than that, but not really essentially different from it. When the world was busy inflating on the basis of war accumulated liquidity, most central banks were saying: "There is not really much we can do about it." There was no difference in interest rates between the big financial centres. The bill rate in Canada was less than one per cent in 1951; and the rate in the United States may have been exactly the same, and in the United Kingdom even lower. This was a period when there was no real monetary policy.

The world has moved from that period in the early 1950's to a period when differences in short-term interest rates mean very much, and this has happened as each country has a monetary policy primarily based on the needs of the domestic economy. Differences in domestic conditions will cause differences in

interest rates.

As central banks began to use monetary policy there was a better environment for the stopping of inflation, and it did that, With flexible monetary policy differences in interest rates have become greater, and the need to understand the international effects of these differences and to deal with them has become greater. But that would have been impossible in a world that was still inflating.

COMMISSIONER LEMAN: Would you comment a little more on your earlier statement that you get 90 per cent of the effect you want from short-term interest rate differentials in the 2 to 4½ per cent range -- that you get 90 per cent of what you would get with a swing of from one to 6 per cent. I believe those were the two ranges you gave.

MR. BERNSTEIN: Yes.

COMMISSIONER LEMAN: To illustrate that I think you used the example of what happens to business expectations, et cetera. Would that be so true also in the field of the influence of savings by the people and consumer behaviour, and that sort of thing?

MR. BERNSTEIN: This is a very complicated question, and I think I shall have to give it some thought. I shall have to touch upon the effects of it upon businessmen domestically and internationally, and on savings and investments, and I think I shall need a little time in which to think about it. Perhaps the Chairman would adjourn for a few minutes.

COMMISSIONER LEMAN: Would you rather we touch

...vigorous action.

As central banks began to use monetary policy there was a better environment for the stepping of inflation, and it did that. With flexible monetary policy differences in interest rates have become greater, and the need to understand the inherent effects of these differences and to deal with them has become greater. But that would have been impossible in a world that was still inflating.

CHAIRMAN IRELAND: Would you comment on Milton's remarks on your earlier statement that you had 90 per cent of the effect you want from accommodation at interest rate differentials in the 5 to 6½ per cent range -- that you get 90 per cent of what you would get with a swing of from one to 5 per cent. I believe those were the two ranges you gave.

MR. ANDERSEN: Yes.

CHAIRMAN IRELAND: To illustrate that I think you used the example of what happens to portfolio expectations, et cetera. Would that be so true also in the field of the influence of savings by the people and consumer behavior, and that sort of thing?

MR. ANDERSEN: That is a very complicated question, and I think I shall have to give it some thought. I shall have to touch upon the effects of [illegible] on savings and investment, and I doubt I could [illegible] time in order to [illegible]. Perhaps the Chairman would adjourn for a few minutes.

on this after lunch?

MR. BERNSTEIN: Yes, I would like to start after lunch with that. It seems to be a question that will take a good deal of explanation.

COMMISSIONER LEMAN: I really asked the question in order to have a better understanding of what you mean.

MR. BERNSTEIN: Yes, I want to take that up.

COMMISSIONER LEMAN: We will go into it later, if you think that will be useful.

MR. BERNSTEIN: I want to go into it, but I think we should allow some time for discussion. May we take it up after lunch, Mr. Chairman?

THE CHAIRMAN: Yes, I think that would be preferable.

COMMISSIONER LEMAN: May I ask you a question, the answer to which will be, perhaps, a little shorter? In paragraph 38 of what we call your first paper, at page 10, you say:

> "The most favourable environment for effective monetary policy is a period in which aggregate demand is neither too strong to be restrained nor too weak to be stimulated through credit policy."

That seems like a sort of dead centre position, or a near dead centre position.

MR. BERNSTEIN: That is right.

COMMISSIONER LEMAN: On the other hand, would you say that the monetary authority has a better control when there is a sort of tightness or close

MR. DEBRUZZI: Yes, I would like to
start after lunch with that. It seems to be a question
that will take a good deal of explanation.

COMMISSIONER LEMAN: I really asked the
question in order to have a better understanding of what
you mean.

MR. DEBRUZZI: Yes, I want to take that up.

CHAIRMAN FORAN: We will go into it
later, if you think that will be useful.

MR. EDWARDS: I want to go into it, but
I think we should allow some time for discussion.
Why we take it up after lunch, Mr. Chairman?

THE CHAIRMAN: Yes, I think that would
be preferable.

COMMISSIONER LEMAN: May I ask you a
little question? In paragraph 35 of what we call your
first paper, at page 10, you say:

"The most favourable environment for
effective monetary policy is a world
in which progress toward full employment
can be achieved without too
great a price rise."

There seems here a sort of dead centre position, or
a pure dead centre position.

MR. EDWARDS: That is right.

COMMISSIONER LEMAN: On the other hand,
would you say that the monetary authority has a problem

to tightness, rather than when it is close to dead centre and where it can move either way?

MR. BERNSTEIN: What I have in mind is this: if you have a period in which the public is well supplied with cash that it secured long before as a consequence of a war and government financing, or as a consequence of the great depression, then it seems to me that even a decision by the monetary authorities to tighten money very much will have little effect.

Let me give you an illustration of it. In the cyclical expansion of the United States in, say, 1953 -- 1953 was a peak year -- the banking system had net indebtedness to the Federal Reserve. That is to say, free reserves were negative. That did not have any effect upon the community. It was loaded with cash. Even though borrowers could not get as much as they wanted, there were plenty of other people with excess cash spending too much. You could not do very much with tight money at a time like that.

On the other hand, in 1959 you could bring up the economy sharply with tight money because, in fact, the ratio of the money supply to the Gross National Product was very close to what it had been in the late 1920's.

When there is a serious depression, an easy money policy with plenty of cash held by the public will not help very much by itself. There is the famous Federal Reserve illustration of pushing on a string. It is hard to move the economy by pushing on the credit string in a deep recession. Other measures

will be needed to increase demand at such a time. And with such measures, an easier credit policy will be effective.

The case is different in a mild recession where everybody says: "This is the usual recurring recession that lasts nine months and comes every three years." An easy money policy can encourage investment then because business knows the economy is going to expand once more. If business recognizes that credit is at bargain rates, that it will not be as cheap on the upswing as it is then, business will borrow and invest.

In a recession interest rates should be so low that people will think they are bound to be higher when the recovery comes. The prospective difference in interest rates between the two periods will be enough to induce business to borrow and invest somewhat more in the recession. Monetary policy is more effective in a recession if everybody has the expectation that the recovery will come quickly. Similarly, monetary policy is more effective in restraining the expansion when aggregate demand is not too excessive.

COMMISSIONER LEMAN: It looks like saying monetary policy can do the best job when there is not much of a job to do.

MR. BERNSTEIN: In a sense that is true. You can do the best job when what you are asking monetary policy to do is not beyond its power. It also does its most effective job when it achieves the precise but limited results that you want. I do not

minimize what it can achieve.

COMMISSIONER LEMAN: I would like to relate that to your other statement contained in the paragraph before, where you say:

> "When the economy is already well supplied with cash balances, it is not possible to prevent inflation, in a period of great demand for output, through the ordinary operations of monetary policy."

We have heard from others about the technique of mopping up excess liquidity.

MR. BERNSTEIN: Yes.

COMMISSIONER LEMAN: With respect to these techniques of mopping up when there is too much liquidity coupled with a high demand situation, is it your feeling that the mopping up operation is impossible or just harmful?

MR. BERNSTEIN: I do not think it is harmful particularly, but we must be sure that we are talking about the same mopping up operation. Was it Dr. Holtrop who spoke about his mopping up operation?

COMMISSIONER LEMAN: Several people spoke about it.

MR. BERNSTEIN: Dr. Holtrop's method consisted of compelling the holding of idle deposits which were then released from time to time. This helped to reduce excess liquidity, but not by as much as the compulsory deposits. The community still felt quite liquid because this secondary liquidity was right there and it could be released if needed.

Let me put it this way. Suppose normally I want to keep $500 in a demand deposit. If I have that $500 I will also want to keep another $500 in a savings deposit. Suppose something happens which increases my demand deposit to $1,000. Then even if I were compelled to put $500 into a savings deposit, it would not have any great effect on me, because that is the way I handle my excess cash.

The segregation of excess cash in special accounts in some European countries after the war was helpful,but it could not prevent inflation. For that matter, the American and Canadian holders of cash exercised great discipline in keeping their excess liquidity and gradually reducing it by expenditure, so that it took about thirteen years to absorb it. I would say that kept the inflation under low pressure in the United States and Canada. The inflationary pressure in Belgium and The Netherlands was very much greater than in the United States and Canada, because their shortgage of goods was greater as well as because their liquidity was greater. It is very hard to mop up a flood of liquidity, and the only way to deal with such a danger is to prevent it. If you have not prevented it I am in favour of mopping it up the best way you can. Even if you do not succeed in doing a very good job, at least you will be better off for having tried.

COMMISSIONER LEMAN: But if you have let it become excessive and do proceed to mop up, are there side effects that may be harmful?

MR. BERNSTEIN: If there is excess liquidity, there must be excess demand. Therefore, a moderate means of mopping up the excess liquidity would not cause a deficiency of demand. The easiest way to mop up excess cash is by offering a higher interest rate on bonds. At a higher interest rate, the public will prefer to keep a larger proportion of its assets in bonds rather than cash. Of course, if the rise in interest rates is large and sudden, it may cut off investment that would have been undertaken at a lower rate of interest. This is a risk inherent in mopping up a large excess of liquidity. It would not be a risk when the excess liquidity is moderate and the corrective measures that are taken are moderate.

COMMISSIONER LEMAN: Following that a little further, at the beginning of this section you make the statement that one of the primary tasks of the monetary authority is to control and determine the money supply; and you give the Federal Reserve Board's definition of "money supply", which is fairly restricted -- it is just "money".

MR. BERNSTEIN: That is right.

COMMISSIONER LEMAN: One paragraph later you begin to talk about what I interpret to be near money. Then I understand there is also, in the measurement of the total need for these various types of money, the problem of velocity that comes in there; that is, the velocity of turnover of money. You say:

"As a practical matter, monetary policy

MR. HUMPHREY: If there is excess liquidity, there must be excess demand. Therefore, a necessary cause of mopping up the excess liquidity would be, cause a deficiency of demand. The easiest way to mop up excess cash is by offering a higher interest rate on bonds. At a higher interest rate, the public will prefer to keep a larger proportion of its assets in bonds rather than cash. Of course, if the rise in interest rates is large and sudden, it may cut off investment that would have been undertaken at a lower rate of interest. This is a risk inherent in mopping up a large excess of liquidity. It would be a risk when the excess liquidity is created through our expansionary measures that are taken now.

CHAIRMAN MARTIN: Without objection, I think, therefore, at the beginning of this meeting you will take the statement that one of the primary tasks of the monetary authority is to control and determine the money supply; and you give the Federal Reserve Board's definition of "money supply", which is defined -- it is just "money".

MR. HUMPHREY: That is right.

[illegible]

just begin to get more when I inquired to be sure about. Then I understand there is [illegible] the need for these reserves if there is [illegible] the problem of velocity, I'll grant you that. But it, the velocity of money, does

acts on the money supply by constant short-run adjustment of credit conditions ..." --- rather than by a sort of dogmatic view as to how much the money supply should be at any given time.

MR. BERNSTEIN: That is right.

COMMISSIONER LEMAN: Do you argue at the same time that normally the money supply should follow the rate of change in the Gross National Product -- and I believe you said this was in the long run?

MR. BERNSTEIN: In the long-run that is what would happen.

COMMISSIONER LEMAN: The definition of what the proper money supply is at any given time -- and I am not talking about rate of interest now -- is that something too difficult to define because of these problems of velocity and near money, you do not have a bench mark?

MR. BERNSTEIN: Qualitatively I can do something with the concept you have given me. First of all, the distinction between money and near money is itself largely a question of velocity. To what extent are savings deposits money? They are money to the extent people actually withdraw them to use them for spending. When the velocity of a particular liquid asset becomes very low you are justified in saying, "We will not call it money." That does not mean it does not have an effect similar to money. For example, I might very well feel that I could have $1,000 half in demand and half in savings deposits. But at 4 per cent interest on savings deposits I might

prefer to have somewhat less in my demand deposit and somewhat more in my savings deposit, even though occasionally it brings my cash very low. One reason I am willing to reduce my demand deposit and take the risks that go with it is because I know I have this saving deposit waiting for me.

The proper money supply requires a very complicated definition. We like to put it in functional terms, in the sense that there is more than one dimension to it. The proper money supply is the quantity of currency and demand deposits which, associated with other forms of liquid assets, would bring a rate of interest that would induce, on an average, the level of employment and production you want. So we cannot separate it from the intererst rates, and we cannot separate it from the other types of liquid assets, because it is the combination of types, the near money with the money that makes the interest rate. We have to keep these things together.

If an economy has sufficient inducement to invest to bring about a high level of employment at a constant average rate of interest, then I would say that in the absence of big changes in the institutional arrangement for holding near money, the money supply ought to grow with the G.N.P.

On the other hand, suppose we have an economy in which savings are large and businessmen do not feel great pressure to undertake investment in anticipation of growing demand. In such an economy you have to have lower interest rates and that would

mean a larger money supply relative to the Gross National Product. Does that help a little?

COMMISSIONER LEMAN: Are you really saying there is no point in trying to define what is the right money supply?

MR. BERNSTEIN: I cannot tell you in advance what the proper money supply will be, without knowing (a) what the development of the economy will be; and (b) what requirement of the rate of interest associated with that will be, because in the long run that rate will be closely related to income and money supply. If other institutional factors create new types of savings instruments that are attractive,there will be other changes. But in the absence of those, the money supply will have to grow faster if the community is having difficulty in undertaking enough investment to maintain a high level of employment. The money supply can grow more slowly if the economy is pressing to undertake more development.

COMMISSIONER BROWN: Is the rate of change in money supply of more importance than the absolute quantity?

MR. BERNSTEIN: In the short period or long period?

COMMISSIONER BROWN: At any time.

MR. BERNSTEIN: I do not think we can be satisfied with just the direction of change in the money supply. A money supply that grows at the rate of one per cent per annum is very unlikely to be adequate for the United States and Canada, with any kind of

mean a larger money supply relative to the Gross
National Product. Does that help a little?

COMMISSIONER LEMAN. Are you really saying there is no point in trying to define what is the right money supply?

MR. BRUNSTEIN: I cannot tell you in advance what the proper money supply will be, without knowing (a) what the development of the economy will be; and (b) what requirement of the use of increased savings there will be, because in the long run that rate will be closely related to income and money supply. If other institutions favored specific types of savings instruments over others attracted-to-them will be other changes. But in the absence of those, the money supply will have to grow faster if the community is having difficulty in accomplishing enough investment to maintain a high level of employment. The money supply can grow more slowly if the economy is planning to undertake more development.

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MR. BRUNSTEIN: In the short period or

long period?

MR. BRUNSTEIN: I do not think we can be satisfied with just the direction of change in the money supply. A money supply that grows at the rate of one per cent per annum is very unlikely to be adequate

institutional arrangement for other liquid assets. We know that is too low. The fact that the money supply has not grown in the past three-year period by more than that is not significant.

On the other hand, if the increase in the money supply is between 2 per cent and 3 per cent a year, it is not possible to say, in advance, whether this will be adequate without knowing how persistent the excess or deficiency of demand will be. The monetary authorities cannot plan on the basis of what monetary needs will be in years ahead. They have to go from day to day and week to week, and if over a period of three or four years the money supply has not increased as much as usual, it is likely that there have been changes in the preference for holding money which, for the time being, have obviated the need for a larger increase in the money supply.

COMMISSIONER BROWN: Before the changes?

MR. BERNSTEIN: The best test of the growth of the money supply is from one period of the cycle to the corresponding period in the next cycle.

COMMISSIONER GIBSON: Would it be fair to say you are more or less in sympathy with the Radcliffe Committee when they say that what is important is the whole structure of liquidity?

MR. BERNSTEIN: As an old teacher of money I would be reluctant to think that it is not important to act on the money supply. The monetary authorities act on the availability of credit which, in the ordinary course of events, would change the money supply,

institutional arrangement for other high areas.

...more than is too low. The fact that the money supply has not grown in the past three-year period by more than that is not significant.

On the other hand, if the increase in the money supply is between 2 per cent and 3 per cent a year, it is not possible to say, to persons who buy this will be attended without knowing how restrained the excess or deficiency of demand will be. The monetary authorities cannot plan on the basis of unit monetary needs will be in years ahead. They have to act from day to day and week to week, and if over a period of three or four years the money supply has not increased as much as usual, it is likely that there have been changes in the preference for holding money which, for the time being, have obviated the need for a larger increase in the money supply.

COMMISSIONER BROWN: Before the chairman?

MR. BERNSTEIN: The best test of the growth of the money supply is from one period of the cycle to the corresponding period in the next cycle.

COMMISSIONER CARSON: Would it be fair to say you are more or less in agreement with the Radcliffe Committee when they say this is the important factor in the whole structure of liquidity?

MR. BERNSTEIN: As an old student of mine, I would be reluctant to think that it is not important to act on the money supply. The question is more on the availability of credit, not so

if the community had a preference for more cash balances.

As far as the monetary authorities go, they act as if they were intent on increasing the money supply. They supply banks with more reserves, by open market operations or by not offsetting an influx of gold or foreign exchange. In the ordinary course of events, such a credit policy makes the banks behave in a way that increases the money supply. If the money supply does not increase, it means that the community prefers a new pattern of holding liquid assets. I would not be dogmatic at all on the proposition that the central bank must increase the money supply so much in the short run. I would be reluctant to be dogmatic as to what the increase should be from cycle to cycle, though I have a feeling that if you take a longer view -- which is not really relevant, because you cannot make monetary policy ten years ahead -- I would be quite surprised if, over ten years, you did not get a rough approximation in the growth of the money supply and the growth in the Gross National Product.

COMMISSIONER GIBSON: Do you think this could be achieved through the sort of traditional instruments of monetary policy? We have heard quite a little about the secondary creation of credit. We have had experience of how when interest rates are rising quickly this process is accelerated. We have heard talk about near banks in this connection.

THE CHAIRMAN: Before you answer that question,

which might involve quite a long answer, I think this might be an appropriate time to adjourn for lunch.

--- Luncheon adjournment.

--- On resuming at 2.20 P.M.

COMMISSIONER MACKINTOSH: The Chairman has been detained and it will be a few minutes before he arrives. However, I think we might resume the discussion. There was a question by Mr. Gibson, I think that was left unanswered.

COMMISSIONER GIBSON: I do not think Mr. Bernstein left the question unanswered. It was just a question of not sufficient time.

MR. BERNSTEIN: Yes.

COMMISSIONER GIBSON: It had to do with liquidity, and then we got on to the question of whether the orthodox methods of monetary policy were adequate in a situation where you had substantial or sharply rising interest rates, and whether a substantial increase there facilitated the secondary creation of credit. Would you like to answer that now?

MR. BERNSTEIN: I think this is true in a period in which there is a marked tendency towards excessive demand. That is when the community holds a great deal of liquidity in the form of savings deposits or other liquid assets that are quickly redeemable. Then the problem of limiting aggregate lending for investment purposes becomes more difficult. In such circumstances the monetary authorities can put some pressure on the money supply by a tighter credit policy. People would be induced to convert some of their near money to money. Institutions with deposits of near money hold very small reserves, and would be quickly pressed for the cash. If they

--- On recess at 2:30 P.M.

do not have access to the commercial banks, they would have to cut their lending a good deal. In a period in which demand is close to being excessive, the lending of these institutions makes it more difficult to prevent inflationary pressure in the economy.

What the solution should be is more difficult to say. On the whole I thought Professor Lundberg had a very interesting point when he said that any institution that holds itself forth as an acceptor of deposits is in a relationship to the public where it ought to be regulated in one way or another. I would not take the same attitude towards some other liquid assets. It seems to me that you cannot very well regulate the issue of short-term paper even though high-grade commercial paper makes it a good substitute for money. Some of the major United States companies like Sears-Roebuck and General Motors issue commercial paper on the market, and this commercial paper is bought by those who want a very liquid investment which pays a little more than Treasury bills.

COMMISSIONER GIBSON: It is the usual corporation trading in demand deposits?

MR. BERNSTEIN: Yes, this becomes a competitor of money and other liquid assets in a very real sense. I cannot see the monetary authorities managing the privilege of industrial or commercial organizations to issue such paper, even though the paper is so liquid that it is competitive with bankers' acceptances and

do not have access to the commercial banks, they would have to cut their lending a good deal. In a period in which demand is close to being excessive, the lending of these institutions makes it more difficult to prevent inflationary pressure in the economy.

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CHAIRMAN GIBSON: It is the usual

comparison drawing in demand deposits

MR. MARTIN: Yes, that becomes a comparison of money and other liquid assets in a very real sense. I cannot see the monetary authorities denying the privilege of industrial or commercial corporations to issue such paper, even though one regrets in a liquid that it is competitive with perfectly good assets and

Treasury bills.

I thought Professor Lundberg did have an important point with respect to deposits. I think it is appropriate for the monetary authorities to take cognizance of any institution that accepts deposits, although their attitude may very well be: "We are just supervising the institution without exercising control." The right to control ought to be there.

COMMISSIONER GIBSON: Is one of your reasons for feeling it is undesirable to have very high short-term interest rates the fact that such short-term interest rates do accelerate the velocity of the secondary creation of credit?

MR. BERNSTEIN: Yes. All of us have been brought up to think of the money supply, in the traditional definition, as having a special relationship to the capacity of the economy to finance production, income and spending. High interest rates will induce a shift from money to other liquid assets, and this may even decrease the money supply in the traditional sense, although the community feels more liquid. Still, the lending power of all lending institutions will be increased by such a shift in the holding of liquid assets in response to high interest rates. There is no doubt that the existence of institutions that are close to banks and of assets that are close to money complicates the problem of monetary management. But that does not mean that monetary policy is bound to be ineffective.

COMMISSIONER GIBSON: No, I realize that. Thank you.

I thought Professor Lundberg did have an important point with respect to deposits. I think it is appropriate for the monetary authorities to take cognizance of any institution that accepts deposits, although their attitude may very well be: "We are just supervising the institution without excessive control." The right to control ought to be there.

COMMISSIONER CLARK: Is one of your reasons for feeling it is undesirable to have very high short-term interest rates the fact that such short-term interest rates do accelerate the velocity of the secondary creation of credit?

MR. BURNSTEIN: Yes. All of us have been brought up to think of the money supply, in the traditional definition, as having a special relationship to the capacity of the economy to finance production, income and spending. High interest rates will induce a shift from money to other liquid assets, and this may even decrease the money supply in the traditional sense although the community feels more ill at ease. Liquid assets in response to high interest rates will be increased by such a shift in the holding of assets, the lending power of all lending institutions is no doubt that the existence of institutions that are close to banks and of assets that are close to money complicates the problem of monetary management. But that does not mean that monetary policy is powerless to be effective.

COMMISSIONER CLARK: No, I realize we

COMMISSIONER LEMAN: Mr. Bernstein, because you have talked about what we call near banks in answer to Mr. Gibson's question, rather than wait until later may I ask you about that now? I would like you to deal with that now.

MR. BERNSTEIN: Yes.

COMMISSIONER LEMAN: I have a short question. Professor Lundberg, when he was commenting on this fact, did mention the effectiveness of monetary policy as a factor in justifying control. He did mention that they had become competitors of the commercial banks under certain conditions, and he seemed to think there was some merit or value in saying that if two people do about the same thing and you decide to control one then why not control the other. Perhaps you would answer that this is not a monetary problem.

MR. BERNSTEIN: No, I will not say that. It may be a political problem, but it has monetary overtones.

I hold that it is a responsibility of the monetary authorities to supervise and if necessary to regulate institutions that take deposits and make loans because these institutions are involved in credit policy. That includes the near money institutions. Whether a central bank should take over such a big job depends on whether the lending activities of these institutions are large enough to have a significant effect on the economy and whether the general trend of their lending is contrary to what the monetary

COMMISSIONER IRVAN: Mr. Bennett, because you have talked about what we call near banks in answer to Mr. Gibson's question, rather than wait until later may I ask you about that now? I would like you to deal with that now.

COMMISSIONER IRVAN: I have a short question. Professor Lindberg, when he was discussing, or in fact, did mention the effect that of tax [illegible] policy as a factor in justifying control. He also mention that they had become competitors of the commercial banks under certain conditions, now he seemed to think there was some merit or value in [illegible] that if one people do start the same thing and [illegible] decide to control one then why not control the others. Perhaps you would answer that this is not a monetary problem.

MR. EDWARDSEN: No, I will not say that. It may be a political problem, but it has members.

I feel that it is a responsibility of the monetary authorities to supervise and if necessary, to regulate institutions that have deposits and make loans because these institutions are involved in credit [illegible]. This includes the near money financial [illegible] a central bank should take over and [illegible] depends on whether the lending activities of these institutions are large enough to have a significant effect on the economy and whether or not central bank [illegible] of their function is to what the [illegible]

authorities would like. There will be times when these institutions are making it more difficult to make monetary policy effective. I think this will be less true when there is less inflationary pressure in the economy. There will be less reason for regulating the near banks when the economy is free of inflation, because then the excess of lending of all types from all sources will not be so great. You will not be disturbed by the fact that there are other institutions than the commercial banks making loans for consumer credit or other purposes when the central bank is asking the commercial banks to lend less. This is much less important when the economy does not have inflationary pressures.

COMMISSIONER LEMAN: Can we now return, Mr. Bernstein, to the question that you said should be left until there was time to explore it, namely, does the working of interest rate fluctuations or changes affect other sectors except investment for business purposes? Does it have an effect on people's savings -- the propensity of people to save? Does it tend to bring about increased savings or reduce them? Let us take that one first.

MR. BERNSTEIN: In the absence of studies showing otherwise, I think we would be justified in saying that persons or individuals -- I am not talking about corporate entities at this moment -- are not very much affected in the amount of their spending and saving by moderate changes in interest rates.

You may be familiar with all sorts of arguments

where inflation are making it more difficult to
make monetary policy effective. I think that's
the less true when there is less inflationary pressure
in the economy. There will be less reason for Federal
Reserve banks when the economy is free of inflation,
because then the purpose of lending or not lending upon
all sources will not be so great. You will not be
disturbed by the fear that there are other uncertain,
than the commercial banks making loans for commerce
overall or other purposes when the demand that is
really the commercial banks to lend is not there if
there is adequate money in order to [illegible]

CHAIRMAN MARTIN: Can we do it today,
Mr. Hayes[illegible], to the question that Mr. Mills
has just asked? I would like to enquire by [illegible]
does the working of Regulation Q [illegible] actions or
changes affect other sections enough [illegible] for
business purposes? Does it have an effect on people's
savings -- the propensity of people to save? Does
it tend to bring about increased savings or lesser
ones? Let's take that one first.

MR. HAYES: In the absence of [illegible]
[illegible] pressure or inventories -- I am not [illegible]
where corporate entities at this moment -- are not
[illegible] in the amount or on it [illegible]
and saving by moderate [illegible] [illegible].

to prove that in the aggregate there is a positive relationship between net saving and interest rates. When interest rates are low people have to draw on capital to live and therefore savings are reduced. On the other hand, life insurance premiums and contributions to pension funds must be larger when interest rates are lower and therefore savings are increased.

I believe, of course, that interest rates have a good deal to do with the form savings take. But my inclination would be to say that although there is a positive correlation between interest rates and saving, the response of savings to a rise in the interest rate, under given economic conditions and prospects, is not very great.

COMMISSIONER LEMAN: In any event, if there is an influence would it be logical to think that it would be the long-term interest rates that people would look at for creating habits of saving rather than the short-term interest rates?

MR. BERNSTEIN: Yes. Short-term interest rates may affect consumer credit and therefore total consumer spending relative to personal income, because there are the rates that the lenders themselves pay for the borrowed money which they re-lend for consumer credit. The traditional type of personal saving is much more likely to be affected by the long-term interest rates than by short-term interest rates.

COMMISSIONER LEMAN: Mr. Bernstein, I think you touched before lunch on the fact that it is not only what short-term interest rates do, but the effect that they have on people's expectations -- the psychological reactions.

to prove that it is the case there is a positive relationship between net saving and interest rates. When interest rates are low people have to draw on capital to live and therefore savings are reduced. On the other hand, life insurance premiums and contributions to pension funds must be larger when interest rates are lower and therefore savings are increased.

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CHAIRMAN MARTIN: In any event, if there is an influence would it be logical to think that it would be the long-run interest rate that people would look at for creating habits of saving rather than the short-term interest rate?

MR. SHERRILL: Yes. Short-term interest rates may affect consumer credit and thereby bulk consumer spending relative to personal income, because there are the sense that the lenders themselves pay for the borrowed money until they demand for consumer credit. The traditional type of personal saving is much more likely to be affected by the long-term interest rates than by short-term interest rates.

CHAIRMAN MARTIN: Mr. Bopp, I think you touched before lunch on the fact that it is not only what short-term interest rates do, but the effect that they have on people's expectations -- the psychological reactions.

MR. BERNSTEIN: Yes.

COMMISSIONER LEMAN: Would you tell us first of all if this is characteristic of the United States? Are they different there from what they are elsewhere? I am thinking of the fact that Lord Cobbold told us that the bank rate in London is a very, very strong signal, and not only is it a signal but it affects the practices and habits of institutions who say that their lending policy is the bank rate plus a fixed percentage, whereas, I believe, in Canada and the United States this same relationship does not exist. What are the implications of these differences?

MR. BERNSTEIN: We have a concept of a flexible interest rate policy for domestic purposes. The interest rate is not the immediate objective of the monetary authorities, but the corollary consequence of acting on the availability of credit. Nevertheless, it is a fact that this involves a rise in interest rates when the monetary authorities are tightening credit either passively or actively and a fall in interest rates when they are easing credit either passively or actively. I must emphasize that for domestic monetary policy, it is the availability of credit rather than the interest rate which is the immediate objective. But interest rates rise and fall with changes in the availability of credit.

The manner in which this rise and fall of interest rates operates on the economy, apart from the availability of credit that accompanies it, is the

question we want to discuss?

Now, first, it is the short-term rate that changes a good deal. The long-term rate changes much less, though in my opinion it could be shown the changes in the long-term rate do tend to be more in the course of a cycle than complete foresight on the behaviour of the short-term would justify. I will put it this way: in a recession the yield on government bonds falls a little more than it should relative to short-term rates, and in an expansion the yield on government bonds rises a little more than it should relative to short-term rates. But the change in short-term rates is a factor in causing a change in long-term rates.

Suppose we could project a known rise and fall of the short-term interest rate. Then if we knew that at some time two or three years in the future the long-term interest rate will be 4 per cent, we could determine what the long-term interest rate should be now.

We can show that if the prices of government bonds are bid up, and that bidding up has been more than would have been justified by the actual behaviour of the short-term rate, and the expectations on the long-term rate, it would have been better to have bought treasury bills and kept on turning them over at a lower yield until sometime in the future when the price of government bonds has fallen and the yield has risen once more. We get more flexibility, on the whole, in long-term interest rates than complete

fore-knowledge would justify on a cyclical basis. That is probably because bond buyers over-estimate the duration of the expansion, during expansion, and of the recession, during recession.

But, one of the important elements about the short-term interest rate is that it acts on expectations regarding the long-term rate. A change in the short-term interest rate creates new expectations regarding the long-term interest rate, and these changed expectations on the long-term rate are in many respects more important than the actual rise or fall in the short-term rate.

It is true that if you could keep money very low -- treasury bills at one per cent for a considerable time -- that this would be a very powerful instrument for stimulating the expectations of a lower long-term interest rate; but even with very easy money this period of a one per cent bill rate may last only three or four months.

As soon as the recovery begins, there is some tightening of credit active or passive. So when we talk about having a one per cent to 5 per cent range in money rates instead of a 2 to 4 per cent range, the period in which the one per cent rate actually acts on the economy is limited to about three months.

In my opinion there is not enough difference in the effect on the long-term interest rate to justify a very low short-term interest rate that will induce a large outflow of funds. You get about 80 per

cent as much impact on the economy by a flexible interest rate policy operating in the United States within a range of between 2 and 4 per cent as in a range of one to five per cent. In the United Kingdom, the equivalent range would be between 3 and 5 per cent, and the same may be true for Canada.

Now, one other aspect of this question. The ideal method of having interest rates behave, if you could really do that, is to get a rate of interest which becomes a signal -- either by psychology or by the derived effects on long-term rates that interest rates are as high as they will be or as low as they will be for some time. If you can get a high rate in a period of excessive demand which is such a signal, then people will say, "This rate must be lower a year from now; therefore, it will pay us to put off our investments for one year; even if we don't get into the tail end of the boom market with some output." You have created an interest rate which has generated expectations that it must be lower in the future and it will pay to put off borrowing. And in a recession you want to have a rate which generates expectations that it must be higher later, so that those who can borrow and invest have a big inducement to do it now. And, of course, the more there is confidence that the economy will recover after a short recession the greater that inducement will be.

It is true there are complexities there; the borrower may be able to borrow now when the interest rates are low and keep the funds invested in short-term

paper until next year. But nevertheless there are other borrowers who don't have that alternative. Take the man who wants a low rate mortgage on his house. He doesn't have the privilege of telling the insurance company that he will borrow the money now at this rate of interest but that he will build the house next year.

We want to create these expectations in a boom and in a recession. The fact that the bank rate does do this in England makes the bank rate much more effective. The fact that we don't do this in the United States with the Federal Reserve discount rate and that you don't quite do it with the Canadian bank rate doesn't alter the fact that these expectations are created by monetary policy in both the United States and Canada. It is not as dramatic as bank rate, but the fact is that those who are responding to monetary policy are affected by treasury bill rates and other money market rates. In England the main reason why bank rate is so effective is that the tie between bank rate and the treasury bill yield -- the most important liquidity instrument -- is much greater than between the Federal Reserve discount rate and the treasury bill yield in the United States. In the United States you can have a treasury bill rate which falls short of the discount rate of the Federal Reserve Bank for a very long time and you can have it all through the cycle if the Federal Reserve Bank wishes. In fact, we require that relationship to be there. If the treasury bill rate went above the federal discount rate we would be disturbed about the

possibility that banks would come in to borrow merely to squeeze some profit out of the treasury bill market.

In the United Kingdom the whole system depends on the fact that treasury bill yields will at once move with the bank rate because the biggest dealers in treasury bills depend on the Bank of England for the marginal money they need in a period of tight credit. Ours is a different system,but it is just as effective because the principal liquidity instruments are behaving the way we want. Monetary policy can make them behave as we want within limits and that calls forth the response we want, within limits, so that monetary policy is effective.

COMMISSIONER GIBSON: Haven't you pretty nearly made a case for the United Kingdom and some of the European countries for big changes, for a wide range of movements in bank rates? You seem to me to be putting so much emphasis on what the market change in the bank rate would do, the expectations, and I wonder if this is consistent with the idea you were suggesting earlier, that you wanted a smaller range.

MR. BERNSTEIN: A large change in bank rate frightens people into thinking that the situation is worse than it is. It overdoes the job. It does create these expectations, but at the same time it creates an image of an economy that has neglected policy until it has to adopt crisis measures if bank rate goes to 6 per cent. It would be a mistake to have the United Kingdom always operating with bank rates this high. It is true that once in ten years

bank rate used to go to 6 per cent in the days of the gold standard and the unrivalled position of sterling. Even then, it was not a satisfactory way to deal with credit policy.

COMMISSIONER GIBSON: But Dr. Holtrop, in speaking of the Dutch experience,and Professor Lundberg of the Swedish, both made this point quite strongly that sharp changes in rate were effective.

MR. BERNSTEIN: I want to qualify that with my proposition that what we need in this world is less policy that looks as if it is made for crises and more policy that is made to deal with gradually changing problems that will be adjusted if we act in good time in dealing with them. This is what I would prefer.

THE CHAIRMAN: I understand your position would be that the policy that you have outlined is not designed to eliminate cyclical movement, it is designed to minimize the ill effects?

MR. BERNSTEIN: That is right.

THE CHAIRMAN: I suppose there might be some benefits resulting from a certain amount of cyclical movement?

MR. BERNSTEIN: In interest rates or in the economy?

THE CHAIRMAN: The economic effects of the cyclical slight depression; it might have salutary results?

MR. BERNSTEIN: I wouldn't myself rate the consequences of the ---

THE CHAIRMAN: I was thinking that it might result in some efficiency later on.

MR. BERNSTEIN: I would tend to discount this. I would say that the only case in which there is a rational basis for risking the inducement of a moderate recession is when you fear that failure to restrain the expansion will result in inflation. As you can't just level off aggregate demand, you may overdo it. If that does lead to a minor recession, I say that that is one of the risks we may want to take under inflation conditions.

It seems to me the monetary authorities do not have as much option as the question might imply. The economy has a natural tendency to fluctuate and the real question before us is this; can monetary policy limit these real forces so as to minimize the fluctuations? My answer would be yes. I wouldn't be disturbed about the economy because it had a periodic contraction lasting nine months with 5 to 6 per cent unemployment. I wouldn't say that is a failure of policy.

On the other hand, I think we can exaggerate how much stimulus a recession can be to shaking up the inefficient producer, to inducing a movement of labour to expanding industries, and to maintaining stability of wages and prices. I wouldn't recommend mild recessions as an objective of monetary policy.

THE CHAIRMAN: I wasn't thinking of that, I was wondering whether it had a side effect which wasn't entirely bad.

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THE CHAIRMAN: I wasn't outlining it that; I was wondering whether it had a side effect which wasn't entirely bad.

MR. BERNSTEIN: I wouldn't rate these side effects so high as to want to pay very much for them.

COMMISSIONER LEMAN: In talking about the effectiveness of policy you said ---

MR. BERNSTEIN: May I interrupt with one observation. The conclusion I come to is that we should do as much as we can in the way of measures to minimize the recession.

THE CHAIRMAN: Because you can't -- at least, so far as you haven't devised a means of completely eliminating it.

MR. BERNSTEIN: I don't believe anybody could.

THE CHAIRMAN: And have you found some means of providing for a steady increase? Without any cyclical movement there may be some slight disadvantage?

MR. BERNSTEIN: If you could get that -- yes, it is highly probable.

COMMISSIONER LEMAN: In talking about effectiveness, there is not only the fact that the measures you take will have the effect, the desired effect, but the speed with which they will have the effect, and there we get into this problem of so-called lags; how fast is the operation.

Now, I would like first to quote the first sentence of your paragraph 36 where you say:

> "The key to an appropriate monetary policy is easier credit at relatively low interest rates when production and employment are low, and tighter credit and relatively high interest rates when

production and employment are high."

Now, the casual reader might misread that sentence and think that the monetary authorities must act at the bottom of the trough and only at the peak of a high.

MR. BERNSTEIN: What paragraph number is that?

COMMISSIONER LEMAN: Paragraph 36. I assume you would readily grant that if possible the monetary authorities should try to begin to act a little before the turn-around, and is that possible? This is an admission that there are lags in the speed with which the policy operates in the system and that there is a case for the monetary authorities to try to precede the turn-around.

MR. BERNSTEIN: Yes. I think, in fact, that if this sentence had been elaborated more carefully by me -- and the rest of the paragraph, and that is what I have been looking at -- it would have made the observation that depending upon the environment you have been working in you would have acted before the turn in the cycle had occurred.

In the 1957-58 recession, which began in 1957, the monetary authorities of the United States were genuinely disturbed by the inflationary pressures that had preceded the downturn of business. In the last year preceding the downturn-- that is, in the year 1956 to 1957 -- the increase in prices was greater than the increase in real output, with a 3 per cent increase in prices. There was only a 2 per cent increase in real G.N.P. Because of this, the authorities felt

production and employment are high."

Mem. The casual reader might misread that sentence and think that the necessary subtraction must set it the bottom of the trough and only at the peak of a fight.

MR. HUNSBERGER: What percentage number is

CONGRESSWOMAN [illegible]: Perhaps so. I assume you would readily grant that it's possible the mine and conservation should try to borrow not a 10-to-1 bearing one hundred, and is that possible? That is an option that there are long in the mood with what the valley expenses in the spring and that there to try to proceed a case for the necessary restrictions to try to proceed the conservation.

MR. SILVERSTEIN: Yes. I think in fact, more is this reference had been elaborated more ordinarily by me -- are the rest of his paragraph, and that is when I have been local yet -- it would be a case the conservation that depends upon the environment you have been working in you would have acted before it came to the owole had occurred.

In the [illegible] recession, which began in July, the monetary authorities of the United States were significantly disturbed by the inflationary pressures that had pervaded the economy of built-in. In this last year, [illegible] the downturn -- the key is this, as [illegible] to 10% -- the increase in prices for [illegible] with the real economy/a [illegible] ... a ton. Increase only a 2 per cent increase in [illegible] and G.N.P. Because of this, the authorities [illegible]

there was too much inflationary pressure. That is why the Federal Reserve authorities really did nothing to ease credit until the beginning of 1958, which was only four months before the end of the recession.

Until December of 1957 the easing of credit came from a decline in loans rather than from an increase of reserves. It was only in the last four months of the recession that the Federal Reserve took active steps to ease credit and stimulate recovery. I think we can say that the United States today is in no danger of inflation; there is no possibility that an increase in aggregate spending would contribute to a significant rise in prices. Nearly all of it would contribute to an increase in output. In the recession that began in June, 1960, the monetary authorities began to ease credit around February and by the time June came, the beginning of the downturn, the banking system was no longer in debt to the Federal Reserve. This is speedy monetary action. All through this cycle, credit has been kept easy despite the outflow of funds from the United States to foreign centres.

If you ask whether this bolder expansion of credit is a better policy than that of holding back the easing of credit until the recession has begun and has made some progress, I would say that it may depend on the environment. This is a better credit policy for this environment. The credit policy of 1957 may have been a better policy for the other environment, although I am not sure of that. There was a tendency

to see a great danger of inflation in the United States for about a year after the danger had disappeared. Credit was tightened too quickly in 1959 and that was a mistake.

If you are asking about the future, then what we want is prompt action and, if possible, early action, as we can sometimes foresee a change in aggregate economic activity by the flattening out of industrial production. I think that we should have a rather earlier change in credit policy in the future.

COMMISSIONER LEMAN: Would you also say that the earlier you act the less violent you need to be, and that has merit too?

MR. BERNSTEIN: I think that is correct. And if action is taken earlier, and if there is a positive effect from an easing of credit policy -- and I believe there is -- that we can probably shorten the period of contraction and possibly lessen the amplitude of the decline in economic activity.

In the United States and Canada, residential construction for a long time during the 1950's was so responsive to changes in interest rates that there was a cyclical increase in residential construction rate in the latter part of the recession. This helped start the recovery. If action on monetary policy had been delayed for a while, it might have put off recovery for another two or three months. I think there is much to be said for early action. I would rather have early action than deep action.

COMMISSIONER LEMAN: What I am leading up to,

Mr. Bernstein, is to ask you if we could list what you refer to in the next paragraph, paragraph 37, as the ordinary operations of monetary policy. From the U.S. point of view, the ordinary tools used are which?

MR. BERNSTEIN: In the United States?

COMMISSIONER LEMAN: Yes.

MR. BERNSTEIN: The most important tool is open market operations. Another important tool is the discount rate, although it is more important in restraining expansion than in inducing recovery from a recession. Nowadays, the operations of the monetary authorities in different sectors of the securities market -- that is to say, whether they buy long or short securities may also be of some importance in acting on the structure of interest rates.

COMMISSIONER LEMAN: It being long or short, I would like to get back to that a little later. Have there been studies made in the United States as to how fast these various weapons of monetary policy do in fact act in getting right through the system and influencing what you are trying to influence, the real spending of the people?

MR. BERNSTEIN: Of course, we all recognize how quickly open market operations act on the availability of credit. Now, is this greater availability of credit in a recession just a statistical datum, or is there some quick response elsewhere? I have not seen any studies of that. I have pointed out that lower interest rates and easier mortgage terms were very

Mr. Greenspan, is to ask you if we could like what you refer to in the next paragraph, paragraph 2), as the ordinary operations of monetary policy. From the U.S. point of view, the ordinary tools were are what?

M. RENNISTEN: In the United States?

MR. GREENSPAN: The most important tool is open market operations. Another important tool is the discount rate, although it is more important in restraining operation than in inducing recovery from a recession. Nowadays, the overhang of the consumer economies in different regions of the securities market -- that is to say, whether they buy long or short securities may also be of some importance in acting on the structure of interest.

CHAIRMAN ZOLOTAS: It being long or short, I would like to get back to that a little later. Have there been studies made in the United States as to how fast these various weapons of monetary policy do in fact act in getting right through the system and influencing what you are trying to influence, the real spending of the people?

MR. REINSTEIN: Of course, we all recognize that purely open market operations act on the availability of credit. Now, is this greater availability of credit in a recession just a shortfall below, or is there some quick response elasticity? I have not seen any studies of that. I have pointed out that

effective in stimulating residential construction in recession until 1958. The reason that residential construction behaved so remarkably in response to monetary policy is that we had an enormous backlog of unfilled demand for housing during the greater part of this period. More recently it has not been quite that way. Residential construction may be turning down in the United States at a time when mortgage money is more plentiful than at any time in this cycle.

It helps to have an environment in which real demand will respond to the interest rate. In the 50's it worked in residential construction. Quite possibly the local authorities, the municipalities and state governments who are very large borrowers in the United States, respond quickly to the changes in the capital market induced by monetary policy.

COMMISSIONER LEMAN: But is it possible to put any real quantitative terms to this, in terms of months or weeks, or something like that?

MR. BERNSTEIN: I think that long-term interest rates, including the rates on mortgages, will respond quickly to a change in money market rates, that is credit policy, and in the case of bonds, interest rates may even anticipate a change in credit policy. I cannot estimate how much effect this has on investment, although we know it encouraged a quick recovery of residential construction in the past. I believe there are sectors of the economy which are quickly responsive to better terms in the capital market.

effective in stimulating residential construction in recession until 1983. The reason that residential construction behaved so remarkably in response to monetary policy is that we had an enormous backlog of unfilled demand for housing during the previous part of this period. Home recently it has not been quite that way. Residential construction may be turning down in the United States at a time when monetary policy is more stimulative than at any time in this cycle.

It helps to have an environment in which most demand will respond to the interest rate. In this Duke is written in particular the municipalities and state governments who are very large borrowers in the United States, respond quickly to the changes in the capital market induced by monetary policy.

CHAIRMAN VOLCKER: But is it possible to put any real quantitative terms to that, in terms of months or weeks, or something like that?

MR. RANDOLPH: I think that long-term interest rates, including the rates on mortgages, will respond quickly to a change in money market rates, that is clearly policy, and in the case of bonds, interest rates may even anticipate a change in monetary policy. I cannot estimate how much effect that an investor is, although be known it encountered a rather recovery of residential construction in the past. I believe there are lessons of the economic vision are irrelevant to looking terms to the capital mar-

These are not the biggest sectors of the economy, and the amount of the response certainly is not enough to overcome the recession, but it is enough to make a flexible credit policy helpful.

COMMISSIONER LEMAN: You would like to accelerate it, if you could?

MR. BERNSTEIN: Yes, certainly.

COMMISSIONER LEMAN: Is there any relationship between the violence of the action and the speed with which it produces its effect?

MR. BERNSTEIN: With a 6 per cent short-term rate ---

COMMISSIONER LEMAN: You are still talking of the 2 to 4 per cent?

MR. BERNSTEIN: Let me make sure I am clear. To go from 6 per cent to one per cent -- or for the United States, say, from 4½ to one per cent in short-term money, will bring a bigger rise in the prices of bonds than a drop of from 4 to 2 per cent. The bigger the rise in the prices of bonds the more attractive it is to issue bonds and spend the money and the more attractive it is to certain financial institutions to lend on better mortgage terms instead of buying the bonds. But the difference in effect between the one and 2 per cent rate in recession is really very small because the one per cent, particularly, lasts a very short period in the cycle.

Take the contraction of 1957-58. Suppose it started in July. You had four months in 1958 when the yield on U.S. Treasury bills was at or below

There are not one hundredth member of the economy,
and the amount of the response certainly is not enough
to overcome the recession, but it is enough to make
a fundamental policy decision.

CHAIRPERSON FLANNERY: You would like to
[illegible] if you could?

MR. ZEMBEKIS: Yes, certainly.

CHAIRPERSON FLANNERY: Is there any particular
[illegible] the violence of the action and the speed with
which [illegible] its effect?

MR. ZEMBEKIS: With a 6 per cent short-term
rate ---

CHAIRPERSON FLANNERY: [illegible] of
the 2 to 4 per cent?

MR. ZEMBEKIS: Let me make sure I'm clear.
We go from 4 per cent to one per cent -- or ten billion
dollars, say, from 8% to one per cent in short-term
money, with ending a bigger risk in the course of doing
even a step of down 4 to 2 per cent. The bigger the
cause in the prices on stock the more substantive in [illegible]
is to provide financial institutions to lend on
better percentage terms instead of having the [illegible]
the difference to offset between the one and [illegible]
that rate in reduction is really very small because
one, one per cent, partly really, leads a very high
ratio in the stock.

Take the conversion of 1967-68. Response
is caused by duty. You had four months in [illegible] when

one per cent. It is a very short period in which this low rate acts on bond prices or the long-term interest rates.

If the period of cheap money is so short and expectations are complete on what the long-term interest rate will be, I do not think the difference between one per cent money and 2 per cent money can be very significant.

Shall I make an estimate for you of the difference between having one per cent for four months and two per cent for four months, and its significance in relation to the price of bonds?

In the case of a bond selling at par, having the short-term rate go down to one per cent for three months instead of two per cent, that would make a difference of, roughly, a quarter of one point in the price of the bond. As a practical matter, the rise in U.S. Treasury bond prices was as great in 1960-61 with bill yields over 2 per cent as in 1958 with bill yields down to one per cent for three months.

COMMISSIONER LEMAN: But if we visualize the monetary action as being quick, why not assume it would have been, and that your monetary authorities had brought the interest rate down to one per cent, right from the beginning, right at the turn around -- let us say, July, 1957? How long would it have stayed down at one per cent then?

MR. BERNSTEIN: The real question is this, is it possible for the monetary authorities in the one month following the end of the reference cycle

to bring short-term rates from 4 per cent to one per cent, and then continue it at one per cent for seven months, or even eight months, and then as soon as the recovery begins let it go up to 4 per cent or more when expansion is well underway? Is that the policy you have in mind?

COMMISSIONER LEMAN: Yes.

MR. BERNSTEIN: I think that a sudden drop from 4 per cent to one per cent would make some of these people who have subscribed to treasury bills in the weekly auction when they were 4 per cent feel that they have been somehow cheated, because if it drops in the next month to one per cent, they could own the bill for two of the three months, and then sell it for an actual loss in cash. I do not think much would be gained from that.

THE CHAIRMAN: It is the other way round.

COMMISSIONER LEMAN: Yes, it is when you go from one to four.

MR. BERNSTEIN: I am sorry. I meant when credit policy turns around and bill yields go up from one per cent to 3 and 4 per cent. I heard complaints in New York in July, 1958, when one New York bank told me it had bought treasury bills and then found, a week or two later, that they needed money for loans and lost on its treasury bills because it had to sell them after yields rose quickly. I think that in practice there is not much to be gained by suddenly changing the money market in large steps. It takes time to move funds in an orderly way into the market, and it

takes time for their movement into the market to operate on treasury bill yields. You do very well if, within a month after, the monetary authorities have decided to act on the money market rates.

But let us take the figure that you have given us, again. Suppose we succeeded in keeping the rate at one per cent for eigh months instead of three months, at one per cent instead of two per cent, what would be the difference in the price of government bonds that this would imply? This would make a difference of around twenty-two thirty-seconds in the price of a government bond -- say, two-thirds of a point. That is, instead of rising six points it would rise seven points. This is not insignificant. I am sure that some borrowers would feel it is well worth having the extra point. That would be its effect if you could make it at one per cent for the whole period of the contraction, and then resume the higher rate, at 2 or 2½ or 3 per cent.

COMMISSIONER BROWN: On this, I think it was Lord Cobbold who made the point that changes operated in the other direction, in the sense that they get the reaction when they tighten money, and that when they loosen money it is a much more gradual process. Could you give us a picture at the other end of the scale?

MR. BERNSTEIN: I do not believe that in the United States we could say that. It is quite true that in the United Kingdom, where the bank rate counts for so much, it is done that way. In the United States

[illegible] time for their movement into the market to operate on premium bill yields. You do very well it, given a month either, but monetary authorities have decided to act on the money content rather.

And let us take the figure that you have given us, Madam. Suppose we succeeded in keeping the rate at one per cent for eight months instead of three months, at one per cent increase of two per cent. What would be the difference in the price of Government bonds that this would imply? This would make a difference of exactly twenty-two thirty-seconds in the price of a Government bond -- say, two-points of a point. That is, instead of rising six points it would rise seven points. This is not inflationary. I am sure that some borrowers would feel it is well worth wanting the extra point. That would do its effect if you could make it at one per cent for the whole period of the depression, and then raise the higher rate, at 2 or 2½ or 3 per cent.

CHAIRMANSHIP PROBLEM: Or else, I think it was Lord Cobbold who came the point that changes [illegible] in the other direction, in the sense that they sell the recession when they tighten money, and that when they loosen money it is a much more [illegible] process. Could you give us a picture of the other [illegible] of the matter

Mr. [illegible]: I do not believe that in the United States we could say that. It is quite true that the United Kingdom, where the bill rate counts

I would say that the processes of open market operations lowers money market rates quickly and sharply and raises money market rates gradually. I think the process is a rather gradual one in the United States, and it is closer to what you have suggested.

The United Kingdom may let the money market run along at 4 per cent or 4½ per cent bank rate until they decide they cannot wait any longer for the balance of payments to improve, and they have a sudden rise in bank rate to 6 per cent. On the way down they usually go down by stages of half of one per cent.

In the United States we do not depend on the Federal Reserve discount rate to be the active factor in easing or tightening credit. In a period when business appears to be turning down the Federal Reserve may put $500 million into the market in the course of two or three months. This allows the banks to move out of a position of indebtedness into a position of free reserves. The banks buy Treasury bills and bonds and that forces down interest rates. After a period of expansion, the Federal Reserve may decide to tighten credit and the technique is much more delicate. They let the demand for bank loans go up, and keep giving a smaller fraction of resources that the banks need to meet the demand for loans. As a result the banks sell Treasury bonds and bills in order to increase loans. This forces up interest and forces down the price of government bonds. It is also accompanied by borrowing from the Federal Reserve Banks perhaps at a higher rate.

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Reserve may put 1500 million into the market in the
course of two or three months. This allows the
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a position of free reserves. The banks by Treasury
bills and bonds are then forces down rates somewhat.
When a period of expansion, the Federal Reserve
may decide to tighten credit and let rates is
much more reluctant. They let the demand for cash
loans go up, and keep tying a reserve position
of reserves that the banks must to meet the demand
for loans. In a sense the banks sell Treasury bonds
and bills in order to increase loans. This lowers
up interest and forces down the price of investment
bonds. It is also accompanied by borrowing from

Neithercut & Young
Toronto, Ontario

A sudden shift in credit policy is much more likely in the recession. This is, after all, what you have asked for, but it does not operate as much on the interest rates as you suggest it should.

COMMISSIONER LEMAN: I think I can be quite blunt in my question. I gather that you are quite confident that even for very short cycles you do not miss the very low rates, and there are not sufficient lags in the way monetary policy is administered in the United States that you miss them or apparently miss them.

MR. BERNSTEIN: Do you mean, could we offset recessions with a bolder credit policy?

COMMISSIONER LEMAN: Yes.

MR. BERNSTEIN: Not very much more than we do at this time. We have used our monetary policy to moderate cyclical changes, but the view we can offset them seems far fetched. Could we cut in half the amplitude of the cyclical fluctuations? I would be doubtful of it, because in the United States and Canada the amount of decline in over-all economic activity in a recession is very little for a very short period.

Suppose the unemployment rate were a true measure of the decline in economic activity -- I mean, a measure and not an indication. Suppose that unemployment goes from 4 per cent to 7 per cent. That is the same thing as saying that economic activity has gone down from an index of 96 to an index of 93. That is a small drop in economic activity. If you look at the Gross National Product during a recession in the United States you will not see it until you get

A sudden shift in credit policy is much more likely in the recession. This is, after all, what you have asked for, but it does not operate as much on the interest rates as you suggest it should.

COMMISSIONER LEMAN: I think I can be quite blunt in my question. I gather that you are quite confident that even for very short cycles you do not miss the very low rates, and there are not sufficient lags in the way monetary policy is administered in the United States that you miss them or apparently miss them.

MR. BERNSTEIN: Do you mean, could we offset recessions with a bolder credit policy?

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out the rise in prices and put it in real terms, in constant dollars, and then you only get a decline or a flattening out for two or three quarters. You do not get so much decline in over-all economic activity. What you get is an aggregate decline that is very small, but concentrated in a few places in manufacturing and construction. It is hard on those industries and on the people working in those fields.

How much you could change that, I would not be certain. I doubt that you could cut the decline in half in these sensitive sectors. You cannot get people who are beginning to doubt an uninterrupted rise in the economy to borrow and buy, say, automobiles on the same scale when there are indications the economy has begun to slow up. We have to act on aggregate demand and hope the response will then be to minimize the decline in spending on durable goods and construction. That is not easy to do merely with a very easy credit policy.

We can improve our performance, I have no doubt, but the trouble there is not that we have not been bold enough in coming down to a yield of one per cent on Treasury bills. I do not know whether it is any longer in the capacity of the Federal Reserve to bring the yield on Treasury bills down to one per cent. The technique of bringing Treasury bill yields down to one per cent is the same as bringing yields down to 2 per cent, only more of it. More reserves have to be put into the banking system.

But, suppose you have an economy that is very sensitive to alternative methods of holding liquid assets, and particularly sensitive to putting the money into savings deposits or time deposits, or sending it abroad. Then as the Federal keeps pushing the bill yield down towards 2 per cent the response in shifting funds into time deposits and sending money abroad becomes greater, but it is still moderate. And when the bill yield gets near 2 per cent as the Federal keeps on putting in more reserves to bring the bill rate down, the elasticity of substitution of other liquid assets for Treasury bills is so high that the yield does not get down below 2 per cent. That is the situation today when banks are offering better interest rates on time deposits and corporations have become very wise in ways of earning more on their idle funds because of higher interest rates. The effect of the elasticity of substitution of other liquid assets for Treasury bills at rates below 2 per cent is so great that monetary authorities may not be able to push the rate down below 2 per cent. If they try to do it they will have to create so much in the way of free reserves, which will divert so much more into time and savings deposits and into capital outflow, that it would not tie their hands on future monetary policy. The immediate problems would be overwhelming. So, we are talking about something which the monetary authorities can no longer do.

COMMISSIONER LEMAN: Mr. Bernstein, you have described to us how there are certain more sensitive sectors of the economy to these movements

in interest rates -- some sectors are more sensitive than others -- and you gave examples such as house building and municipal expenditure, and so on. Would you say that the monetary authorities should not try to keep their eye on specific responses in specific sectors?

MR. BERNSTEIN: I would think it is always true that if the monetary authorities merely look at aggregates without looking at the constituents they will not be fully aware of the behaviour of the economy. It is essential to look at the constituents. To try to influence aggregate economic activity they ought to know just what is being affected, because that will make for more intelligent monetary policy.

COMMISSIONER LEMAN: I had something more to ask precisely in line with that. What I meant is under a certain set of circumstances would they change their policy in order to influence a certain sector, and in other circumstances have a slightly different policy to influence a different sector?

MR. BERNSTEIN: I think by and large if the monetary authorities are satisfied with the aggregate behaviour of the economy they arevery unlikely to change that policy because they are disappointed in one sector, unless, as we now know, that sector happens to be exports. If one industry is not doing well, say textiles, but the economy as a whole is at a high level of activity, the monetary authorities cannot keep

easing credit until that sector is booming. But if construction and equipment industries are doing poorly, it may be desirable to see whether long-term interest rates can be brought down somewhat.

COMMISSIONER LEMAN: Could I ask you to comment on the different thinking that has evolved, especially in the United States, on this question of operating strictly on the short-term or long-term interest rates? I understand that there was practically unanimous agreement some time ago that it should be a "bills only" or a "bills preferably" policy, and that other ideas have evolved in this field. Can you describe for us what has been the thinking behind this change?

MR. BERNSTEIN: Until a year or two ago the Federal Reserve operations in the open market were almost exclusively the sale or purchase of Treasury bills. This was called either a bills only policy by people who did not like it, or a bills preferably policy by those who did like it.

The Federal Reserve can put money into the market or take it out -- it can put money in by buying Treasury bills, and take money out by selling Treasury bills -- with a minimum effect on the prices of particular securities, as distinguished from the level of government bond prices, by dealing in Treasury bills. Because of the ease of substitution of Treasury bills and other securities, the Federal Reserve authorities can put more money into the market or take more money out of the market through Treasury bills

without distorting the relationship of security prices of different maturities. When money is put in the market through Federal Reserve purchases of Treasury bills, there will be an increased demand for other Treasury securities as investment institutions or dealers move from 3-month Treasury bills to 9-month Treasury bills, and bid them up, and others might move into another maturity a little longer, say three years. So, by successively substituting maturities and inducing small changes in price the market absorbs the new money put in by the Federal Reserve with a minimum of disruption of market relationships, but with the desired effect on the whole pattern of interest rates.

The policy that the new administration favoured was keeping long-term interest rates low to stimulate investment, but to hold up short-term interest rates to limit capital outflow. There was general agreement in the Treasury and the Federal Reserve on this policy; but the question was: Is it possible to keep up short-term rates moderately while long-term rates are kept low relative to their usual cyclical relationship? This has happened. Short-term rates in Treasury bills have been around 2-3/4 per cent recently. They were as low as 2¼ per cent during part of the recession. The long-term rates on government bonds have been between 3.90 and 4.10 per cent, but they have never gone up as high as they were in the expansion of 1959-60.

The Federal Reserve has been acquiring maturities other than Treasury bills. The Treasury

itself has also been shifting the composition of its borrowing. What it has done is to borrow more short-term money, less one-to-five-year money, but also more five-to-twenty-year money. The Treasury has contributed to holding down long-term rates relative to short-term rates by its borrowing policies. The Federal Reserve has also made a contribution to the changed relationship of free reserves, Treasury bill yields and bond rates. But the Treasury and the Federal Reserve were able to do this because the market is forcing a closer relationship of short-term and long-term rates through outflow of funds and substitution by investors of longer maturities for shorter maturities.

Actually, the level of free reserves has not been significantly different in this recession from what it was in the previous ones. But bill rates never went very low. This appears to prove they could not have gone much lower except by a vast increase in the liquidity of the economy. On the other hand, the Federal has kept the free reserves rather large for this stage of the cycle with over $300 million of free reserves in the nineteenth month of expansion. That is a very good record. It has not happened before in the post-war period, and this has been done without any significant cyclical rise in long-term interest rates.

My conclusion is that we have not had very much rise in long-term interest rates because the investors have the expectation, and I think the proper one, that there is no longer a rising trend

in long-term interest rates as the liquidity of the economy will not be reduced.

What brought long-term interest rates up sharply in 1959 was the feeling that there was an upward trend that had not reached its limit. Now that the trend has reached its limit there is no reason why anybody should be worried about too large a change in the prices of government bonds.

Similarly, there is not much reason to hesitate to substitute one type of Treasury security for another at any significant difference in interest rates. They are very good substitutes for each other now -- Treasury bonds, notes, and bills. Their yields have come closer together, and I think one reason is that expectations are for greater stability of interest rates generally. In such a period short-term rates must come nearer the long-term rates.

COMMISSIONER LEMAN: Another thing that other central bankers in other countries seem to believe in as an instrument of monetary policy is this business of shortening and lengthening average government debt. Is that only possible where such debt is relatively small, and impossible when it is so massive as it is in our North American countries?

MR. BERNSTEIN: I think it is much less important in the United States than in Europe, but in Canada it may be a little more important than in the United States.

In the United States, the role of the Treasury bill as a liquidity instrument is much less

than it is in Europe. In Europe banks regard the Treasury bill as a substitute for cash. In the United States the Treasury bill is a substitute for other investment and other lending. The requirement to keep a cash reserve by banks is not met in the United States by holding Treasury bills. As the need for liquidity by a bank does not much exceed the legal reserve requirements, when a U.S. bank buys Treasury bills it is essentially because it knows of nothing better to buy. On the other hand, an English bank buying a Treasury bill feels its liquidity has definitely not been impaired, and it can just as freely create more credit for lending purposes. I would say in the United States, therefore, we do not have to be much concerned about having a larger proportion of the debt in short-term paper.

I am not disturbed by the fact that the short-term debt of the United States has increased. I have also indicated that our long-term debt is a larger proportion of the whole. What has declined is the intermediate debt -- the debt between, say, one and five years. The average maturity of the marketable public debt in the United States has been increased to nearly five years, even though there has been a large increase in the issue of Treasury bills. At the same time, through advance refunding, the outstanding long-term debt has increased even more. The combined effect has been to lengthen the average maturity of the public debt.

THE CHAIRMAN: What is the average?

MR. BERNSTEIN: It is about four years and eleven months.

COMMISSIONER LEMAN: I gather you would not regard it as an important instrument of monetary policy as such -- this process of lengthening and shortening?

MR. BERNSTEIN: No, I do not think it is of great consequence in the United States.

COMMISSIONER LEMAN: With the size of the United States debt it would also be very difficult because you could not move very, very fast?

MR. BERNSTEIN: The debt has a natural capacity to become shorter and shorter as it is in the hands of the public, because the shortest matures, and the longest comes nearer to maturity. Therefore, we can always shorten the average maturity of the public debt simply by not issuing long-term bonds. The temptation to do that was much greater in 1959 than it is now, because in 1959 long-term rates were 4¼ per cent, which is the ceiling on the coupons of the bonds that the Treasury can issue. In 1959, the Treasury was compelled, even against its will, to move into the shorter area. As government bond yields have been much more stable around 3.90 to 4.10 per cent, the inducement to issue longer term bonds through advance refunding has become greater.

COMMISSIONER GIBSON: Mr. Bernstein, I shall have to demonstrate my ignorance on this question of the effect of monetary policy, particularly in regard to its influence in restricting demand. At times you

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COMMISSIONER GIBSON: Mr. Bernstein, I shall have to demonstrate my ignorance on this question of the effect of monetary policy, particularly in regard

said that American policy generally was fairly moderate -- going up gradually. This applies to the present circumstances?

MR. BERNSTEIN: Yes. In previous cycles the Federal Reserve acted rather quickly to restrain demand -- within a few months after the expansion was well marked. Take the case of the 1958-60 expansion. You will remember the great fear there was that this was going to be a deep recession. Within six months after the recovery began the free reserves of the banking system were exhausted.

COMMISSIONER GIBSON: The point I would like to develop a little more is just how exactly this works. We have heard, many people have told us that an increase in interest rates has practically no effect at all. We have heard this from financial corporations and municipalities and economists, and one person told us -- Dr. Holtrop -- that he felt when you had sharp increases(and he was talking in terms of the discount rate) expectations would develop that money was going to be hard to get and also that it would cost more, and that this led quite a few people to actually postpone investment plans, and so on. I can see that. I also felt that the idea of a moderating influence is probably right, but I wonder if you could give a few more illustrations as to how this works on the margin, because you said a few sectors of the economy are significantly affected by changes in policy and the burden falls rather heavily on them. Why does it fall heavily on them when this is just

a modest change in interest. Is it the interest effect that has done it?

MR. BERNSTEIN: In the cases I mentioned, interest is really the big element of costs. The role of interest in the cost of providing housing is relatively high with respect to the total cost of providing such services. The role of interest rates in providing electric power and other utility services is rather high. Similarly, interest is important in all public construction.

COMMISSIONER GIBSON: Somebody will tell us that they have to have a school that year, that there are so many children around and even if it costs more they will do it ---

MR. BERNSTEIN: That is important and even decisive in providing school facilities. But the kind of building that is put up, how much is spent on it, probably is affected by the cost of borrowing money.

THE CHAIRMAN: Of course, in this province the government pays a very large portion of the cost of the new schools, so it wouldn't have quite as much effect.

MR. BERNSTEIN: Well, Mr. Chairman, if the decisions as to undertaking the investment and bearing the cost of the investment have been completely separated you may have no connection between the interest rates and a decision to invest.

MR. CHAIRMAN: The decision is by the local authority of the province.

MR. BERNSTEIN: I think that makes a difference.

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But in residential construction, of course, you understand that the situation is not the same. I don't rest the case for the effectiveness of monetary policy exclusively on the fact that there are some sectors that are very sensitive to the level and prospective level of long-term interest rates. We must admit that when a manufacturing firm must project for at least five years ahead what it is going to do with the output from an investment it undertakes, how the market is going to be, and what the raw material prices and the labour situation will be, the critical point is not whether they have properly estimated the role of 5 per cent or 4 per cent money in such a decision.

On the other hand, suppose that you have created enough expectation that interest rates, though very high, are bound to be lower later because they are very high now. Can that lead them to put off investment for a time?

I suppose that there is no borrower in the United States,apart from the government,that can raise money as easily as the American Telephone and Telegraph Company. Yet in 1959 when money got tight, many subsidiaries of the American Telephone and Telegraph Company announced that they were postponing the issue of bonds until the market had settled down. They put off for six and nine months the raising of this money. It is possible that in the meantime they may have gone ahead with most of the construction they intended, but it is more likely

that they actually put off some of the investment, too.

I think it is clear that public utility managers, considering the big role that interest rates play in their business, can be persuaded to postpone some investment if we create expectations that interest rates are so high that they are bound to be lower later. Companies and local governments may put off the issue of new securities for three months nowadays even when there are minor fluctuations in the bond market.

COMMISSIONER GIBSON: This is when things are a little less urgent, but when it is strong it has much less effect.

MR. BERNSTEIN: That is quite so. The first rise in interest rates may induce people to say, "Money will go so much higher, we had better borrow now ."

THE CHAIRMAN: The cost of construction might rise in the interim.

MR. BERNSTEIN: Yes, and this is quite a problem, Mr. Chairman, of the environment in which monetary policy is made. In an environment of rising prices and rising costs it is extremely difficult to induce people to put off investing; but in that case, Mr. Chairman, the mere unavailability of money may stop them. If the builder goes from bank to bank and they all tell him, "We don't have any money," that may stop him, even if he were willing to pay the interest rate.

COMMISSIONER GIBSON: What about the effect of people borrowing from banks for inventories, receivables, and so on, in that area?

MR. BERNSTEIN: Well, I think we have changed our minds a little on that. Once, the British theory of business cycles, as you know, revolved about the concept that the merchants were so sensitive to interest rates and the holding of inventories, that the cycle resulted from the response of inventories of merchants to the action of the banks on credit. I think we must regard that as less significant.

Nowadays the significant element in determining the extension of commercial credit by one firm to another is the level of business activity, not the credit situation. I don't thin, for example, that any firm is induced to give less credit to a customer because money is tight. But I think there is a possibility that business firms will hold a little less inventory when money is tight and this has a marginal effect on business activity. I think that short-term interest rates and the availability of credit act on the inducement to hold inventories. Even so, inventories are more sensitive to sales and to production, particularly to expected changes in sales and production, than to credit conditions. My inclination is to put the significance of the short-term interest rate for the domestic economy primarily through its impact on the long-term interest rate. Of course, this is apart from the international significance of relative short-term rates for capital inflow and outflow.

CHAIRMAN VOLCKER: What about the effect of people borrowing from banks for investment, reservables, and so on, in that area?

MR. ROSENBLUM: Well, I would we have changed our views a little on that. Once, the familiar theory of business cycles, as you know, revolved about the concept that the monetary was so decisive to interest rates and the pushing of investment, that the cycle resulted from the exigencies of immobilize of reductions to the ratios of the banks on credit. I think we must regard that as less significant.

Nowadays the significant thing in determining the extension of commercial credit by one firm to another is the level of business activity, not the result thereof. I don't think, for example, that any firm is induced to give less credit to a customer because money is tight. Did I think there is a possibility that business firms will hold a little less inventory when money is tight for this or anything else because of unforeseen problems, I think that would short-term interest rates are the availability of credit not on the willingness to hold inventories. Even so, firms are more receptive to using equity production, particularly to expand their or in sales and production than to credit considerations. My inclination is to put the significance of this short-term interest rate for the economic economy primarily through its impact on the long-term interest rate. Of course, this is apart from the international ramifications of relative short-term rates for capital inflow and on

But short-term rates as such do not have a significant effect on employment and production.

COMMISSIONER GIBSON: What about the question of availability of credit as opposed to greater costs which are likely in the short-term area? In other words, when the rates are increasing and money is getting tighter, do you regard the fact that banks try to dissuade the customers from asking for more as adding to the effect of the higher interest rate?

MR. BERNSTEIN: I don't know why we have to try to set one off against the other.

THE CHAIRMAN: It should all be reflected in the price, but in practice it is not so?

MR. BERNSTEIN: No, because banks are not allowed to operate exclusively by way of price. Everywhere there is some limitation on the rate of interest that banks can charge. The banks can try to offset that in part when money is tight by reducing the risks attached to their average loan; it is much easier to cut off the fellows with a lower credit rating when banks have to ration credit, but can't raise interest rates above six per cent. I would say that the availability of credit is on the whole probably more important than the short-term interest rate in acting on the level of business activity.

COMMISSIONER GIBSON: This would depend on whether or not the interest rates were fairly flexible?

MR. BERNSTEIN: Yes, it would depend upon the range of interest rates we are talking about.

But short-term trends as such do not have a significant effect on employment and production.

COMMISSIONER GIBSON: What about the question of availability of credit as opposed to greater costs which are likely in the short-term area? In other words, when the banks are increasing and money is getting tighter, do you regard the fact that banks try to discourage the ordinary borrowing for more on meeting so the effect of the higher interest rates?

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COMMISSIONER GIBSON. Does money depend on how the interest rates are fairly flexible?

MR. [illegible]: Yes, it would depend upon the range of interest rates we are talking about.

But if banks can't charge higher rates and ration credit to their customers, there are other lenders in the United States that will make loans at very high interest rates. This is what happens when some business firms can't borrow in the United States. I don't know whether it can happen in Canada because it may be that your legislation is far more restrictive than ours on interest rates. We were talking about money and near money, and I think it might be well to see what happens in the United States when the banks don't have available loanable funds.

The marginal borrower who has been turned down for a bank loan goes to a factor who will take off his hands -- with or without recourse -- his accounts receivable. Or the marginal borrower will find a lender who will give him credit on his inventory, and the borrower will pay for this 10 and 12 per cent in interest rates. This means that the unavailability of credit is associated with much higher interest rates elsewhere but not at banks. Borrowers who must have money will pay these high rates. No credit may be available between 6 and 10 per cent -- but when credit is unavailable at banks, you really have imposed on many borrowers an alternative of 10 per cent, and that is very restrictive.

COMMISSIONER GIBSON: I have one more question which I would like to ask. When we broke up at the recess this morning you had just started to give us an analysis of the Canadian situation as you saw it and you were talking about the structural problems

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and you gave us a very interesting analysis of the American balance of payments situation and you were talking about the Canadian situation and stated that it was rather different. I wonder if you could finish that one up, because it really never got going.

MR. BERNSTEIN: The Canadian economy is, as we all know, a high income economy because it is a high output economy. It is an economy that had an enormously rapid rate of growth, say, between 1946 and 1956. This was a period when the whole world was under inflationary pressures, and inflationary pressures indicate that the economy doesn't have the resources to provide for all the investment and the consumption for which there is a demand.

Now, during a period like this a rapidly growing high income economy with a growing population, must provide equipment for workers and more housing and consumer durable goods. Such an economy will be hard pressed for resources to maintain the level of investment the community is technically capable of undertaking and businessmen are economically prepared to undertake. I think that that was the case in Canada.

Canada very generously provided large resources for Europe at a time when its own needs were very high, around 1946 to 1949. This was a period in which your own needs were rather great, but the availability of capital from the United States was limited. You did not get much capital inflow until

and you have us a very interesting analysis of the American balance of payments situation and, for some reason, about the German situation and asked what it was rather different. I wonder if you could return that one up, because it really never got there.

MR. BENNETT: The Canadian economy is, as we all know, a high income economy because it is a high output economy. It is an economy that has an abnormally high rate of growth, say, between 1960 and 1966. This was a period when the whole world was under inflationary pressures, and India's many pressures included that the country doesn't have the resources to provide for all the investment and the consumption for which there is a demand.

Now, during a period like this a typical growing high income country with a rising population, must provide employment for workers and more output, and consumer durable goods. Even an economy with the largest resources for continuing economic growth is constantly subject to pressures to restrain the level of investment the community is currently capable of undertaking and sustain the economy's progress to maturity. I think that was the case in Canada.

(Canada very previously previous two, resource for Europe at a time when its own needs were very high, around 19-5 to 1960. This was a period in which your own needs were rather great, but the availability of capital from the United States was limited. For did not, much capital inflow until

1950 and 1951. But then came a flood of capital beginning in 1956 -- from $1 billion to $1.5 billion a year between 1956 and 1960.

The per capita income in real terms in Canada must have been about 30 per cent higher in 1960 than it was in, say, 1950. In 1960 when you had a much higher per capita income you were getting a very large part of your resources for investment from abroad -- nearly 3½ per cent of the Gross National Product and almost 20 per cent of your gross private investment. This is in an economy which was 30 per cent richer per capita than in 1950 and in which aggregate demand was not pressing on your resources. In 1950 when you were poorer and had a great shortage of resources, you were only getting $334 million of capital inflow constituting less than 2 per cent of the Gross National Product and about 10 per cent of your gross private investment.

Now, I raise the question whether the growth of your wealth and the reduced pressure of resources do not naturally call for a policy that would somehow lead Canada to be gradually providing a larger proportion of the savings to finance home investment in Canada. If this had occurred and the economy had been adjusted to it, I believe that the level of employment would be higher in Canada.

Let me put it to you again this way; if Canada had a policy which, over the past 12 years, had succeeded in increasing exports relative to imports by, say, $600 million, and simultaneously

the capital inflow through other measures had been induced to decline by $600 million, with the same level of aggregate demand, employment would have been higher, let us say, by 1½ or 2 per cent of the civilian labour force. It would have made a very substantial increase in the employment situation.

I ask the question whether a country as rich as Canada and with unemployed resources shouldn't have as one of its long-term objectives for purely economic reasons the gradual reduction of its capital inflow and ultimately -- if it gets rich enough and the adjustments have been made -- why should it have any net capital inflow. It should become a country that would in another two decades be taking its place as an exporter of capital, with considerable direct investment abroad.

I am convinced that this policy would have a positive effect in increasing employment and production. And I would say that when you think about the structure of the Canadian economy, why shouldn't a big element in the strengthening of the Canadian economy be a rise of exports relative to imports and a decrease in the capital inflow over the next decade?

This is just as good a way of increasing employment in Canada as you can find; and I believe that Canada can do it. Canada has a remarkably efficient industrial economy, and although your population is not as large as that of some of the larger Western European industrial countries, your aggregate output

is as much as theirs. I see no reason why, given the right policies, you could not assume a larger role in the world export trade of industrial goods. This would contribute a good deal to solving the long-range problems Canada has of production, employment and growth.

COMMISSIONER BROWN: In recent months there has been a considerable amount of discussion in Canada as to whether this long-term and large capital inflow does bring with it long-term future problems for the Canadian economy, from the point of view of servicing its debt.

MR. BERNSTEIN: I would not have thought that for a country like Canada, there would be a big problem of that sort, though it will require adjustments which you could make.

The biggest adjustment you would have to make is to keep the rise in wages relative to productivity a little lower than it would otherwise be. This is not an overwhelming problem over a decade. I do not see any difficulty for Canada in financing remittances of earnings of foreign capital through increased exports of goods and services. Actually, the problem is not different from that of reducing your dependence on a further inflow of capital from abroad. As I think you can do one, I think you can do the other.

COMMISSIONER BROWN: In time, at some stage, there has to be this excess of exports?

MR.BERNSTEIN: Yes, this is going to have to be done because confirmed net borrowing and growth

is as much as there. I see no reason why, given the right policies, you could not assume a larger role in the world export trade of industrial goods. This would contribute a good deal to solving the long-range problems (mainly that of production, employment and

CHAIRMAN BROWN: In recent months there has been a considerable amount of discussion in Canada as to whether this long-term and large capital inflow does imply risk to long-term future problems for the Canadian economy, from the point of view of servicing its debt.

MR. MACDOUGALL: I would not have thought that for a country like Canada, there would be a big problem of that sort, though it will require adjustments which you would have to make/to keep the rise in wages relative to productivity a little lower than it would otherwise be. This is not an overwhelming problem over a decade. I do not see any difficulties for Canada in financing, maintenance of warnings of foreign capital through income exports of goods and services. Naturally the problem is not different from that of reducing your dependence on a further inflow of capital from abroad. As I think you can do one, I think you can do the other.

CHAIRMAN BROWN: In that, at some stage, there has to be this excess of exports?

MR. MACDOUGALL: Yes, this is going to have to be done because continued net borrowing and growth

of foreign ownership of some of your industrial firms are going to lead to remittance of larger profits abroad, which will ultimately exceed the inflow of funds. I am suggesting you might just as well start thinking about policies to reduce your dependence on capital inflow from abroad because it might be wise to provide a larger part of the real resources for your investment yourselves.

I do not think the loss of technical knowledge or enterprise that would come with reducing the net inflow of capital from abroad would be significant. In any case, anyone who wants to come to Canada would continue to do so, but you would not be dependent on going to the New York market for borrowing on the recent scale.

COMMISSIONER MACKINTOSH: Would you suggest things you might have in your mind as the elements of a policy leading to these results?

MR. BERNSTEIN: The significant thing is, first, to create an environment which will result in an expansion of exports relative to imports. Then policies, particularly fiscal policy, to increase home savings. And also a monetary policy, as progress is made, that will encourage financing in Canada rather than in the United States. That will also require a further development of your capital markets.

In my opinion, you have already taken a step which in the long run will prove of great value to Canada. I think the devaluation of the Canadian dollar was a very sensible thing to do, though I have no

judgment to offer as to the best technique to adopt for making such a change -- that is gradual depreciation in a free market or a quick change in parity.

COMMISSIONER MACKINTOSH: I think you really mean you have a judgment.

MR. BERNSTEIN: No, I want to make it clear that I am not certain as to the best way of doing it, although it should be in accordance with the provisions of the agreement of the International Monetary Fund. I think this was a very wise policy. I believe it to be an essential part of any long-run programme for Canada. I think it has started you on the first step in a series of measures to make this rich country what it should be -- a country much less dependent on capital inflow than it was a decade ago, instead of being more dependent.

This requires, then, a very conscious effort to stimulate the export markets of Canada, primarily by increased productive efficiency and lower costs in the industrial sectors where your exports ought to develop. This ought to be a country that exports much the same kind of goods as the United States, the United Kingdom and Germany -- and perhaps an even higher proportion of the high output goods.

It may very well be that a good, cautious policy on the rise of wages relative to productivity, without much pressure at all -- and there is no suggestion we must reduce the wages of the Canadian workers -- will increase exports considerably. And your savings will have to be larger. This will happen,

partly in response to the wage policy and partly in response to a fiscal policy, designed to have less resources used in government consumption relative to taxes. This will leave more of your output available for private investment. And with a suitable interest rate policy and better capital markets, all this will be accompanied by less capital inflow from abroad.

There need not be any time schedule for this. If, for some reason, in a given year you did not quite make the increase in exports relative to imports, you expect, that is nothing to be concerned about. In that year you will have more capital inflow, and the interest rate will be adjusted in that year for that purpose. The next year you will try to make the policy a little more effective. You do not have to make up the deficiency of the preceding year. You are not desperate to end a current account deficit which will cause people to lose confidence in your currency. If you miss in one year, then you will extend the programme. The direction of your programme, its functions and purpose, and conscious effort to achieve it, is all there ought to be in your mind.

I think you will find your production will grow more and employment will be better with these policies than by depending on the inflow of large amounts of capital from other countries.

THE CHAIRMAN: Mr. Bernstein, I wish to tell you, on behalf of all members of the Commission, that this has been a most valuable discussion. You

have assisted us in many ways, and we are very grateful to you indeed.

MR. BERNSTEIN: Thank you, Mr. Chairman. I enjoyed meeting the Commission and doing the little I could to discuss these matters with you.

THE CHAIRMAN: It has been not only instructive to us, but most enlightening and enjoyable.

--- Adjournment at 4.15 P.M. until 9.15 A.M. on Friday, September 14, 1962.

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ESWARD M. BERNSTEIN

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SOME PROBLEMS REGARDING MONETARY RESERVES

BY EDWARD M. BERNSTEIN*

Adequacy of reserves

The concern with the adequacy of gold and foreign exchange reserves is an indication of the disruption in the world pattern of payments throughout the post-war period. Whenever there are serious payments difficulties, there are some economists who regard persistent payments deficits in the great trading countries as the consequence of an inadequate world level of monetary reserves. This was the explanation put forward by some economists for the payments difficulties of Western Europe in the early postwar years. This same explanation is put forward by the same economists for the payments difficulties of the United States in the past four years.

Discussions of the adequacy of monetary reserves seem to be marked by an excessively mechanistic approach. An adequate level of monetary reserves is assumed to have some constant relationship to international payments and to be a necessary condition for the expansion of world trade and international investment. As a practical matter, world trade and international investment have grown very rapidly during the period in which there is said to have been inadequate monetary reserves. In the ten years from 1951 to 1961, the dollar value of world exports has increased from

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* This paper was presented for discussion at the SEANZA Conference of central bank officials in Tokyo, May 25, 1962.

BY EDWARD E. BRADSTREET*

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Discussions of the adequacy of monetary reserves seem to be marked by an excessively mechanistic approach. An adequate level of monetary reserves is assumed to have some constant relationship to international payments and to be a necessary condition for the expansion of world trade and international investment. As a practical matter, world trade and international investment have grown very rapidly during the period in which there is said to have been inadequate monetary reserves. In the ten years from 1951 to 1961, the dollar value of world exports has increased from

$77 billion to $119 billion and private investment has increased from about $1.5 billion to over $4 billion a year. It is difficult to see how world trade and international investment could possibly have been held back by the inadequacy of monetary reserves at any time during the past ten years.

The mechanistic approach to monetary reserves is based on an analogy with the classical gold standard system that prevailed before 1914 and persisted in some form until the early 1930's. When gold formed the basis for the monetary system, being linked to the supply of money by reserve requirements, a shortage of gold meant that the money supply was not adequate for financing production, consumption and investment at a high level of employment and at stable prices. With such a monetary system, each country's policies had to be designed to bring about an appropriate balance of payments. This may be defined as one in which the surplus on current and ordinary capital account, in an average of good years and bad, was sufficient to bring about an inflow of gold to meet a country's growing monetary needs. Of course, if production of newly-mined gold was too little, some or all countries would be unable to maintain an appropriate balance of payments. An attempt by any country to attract additional gold reserves would inevitably disrupt the world pattern of payments. Under such a system, the functioning of the world economy did depend upon the production of sufficient gold to assure an adequate level of gold reserves for all countries.

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production of sufficient gold to assure an adequate functioning of the world economy did depend upon the world pattern of payments. Under such a system, the additional gold reserves would inevitably disrupt the international investment could possibly have been held back by the inadequacy of monetary reserves at any time during the past ten years.

The monometallic approach to monetary reserves is based on an analogy with the classical gold standard system that prevailed before 1931 and persisted in some form until the early 1930's. When gold formed the basis for the monetary system, being linked to the supply of money by reserve requirements, a shortage of gold meant that the money supply was not adequate for financing production, consumption and investment at a high level

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The situation is basically different in the modern world. Gold is no longer the base for the money supply, despite the anachronistic gold reserve requirements in the United States. Foreign exchange assets as well as gold are held as monetary reserves and they constitute a substantial part of aggregate monetary reserves. The International Monetary Fund holds large resources of gold and currencies as a common reserve that can be used by its members under prescribed conditions. Most important, countries now hold monetary reserves almost exclusively for the purpose of financing deficits in the balance of payments. Under these conditions, the relationship of monetary reserves to international trade and payments is much more flexible than it was under the gold standard.

There are some problems regarding monetary reserves that confront the world economy. These problems do not arise from the inadequacy of aggregate reserves of gold and foreign exchange. The world level of monetary reserves is more than adequate at the present time. The practical problems regarding monetary reserves may be stated briefly as follows:

1. How to provide for the orderly growth of monetary reserves in the future.

2. How to protect the world economy from the disruptive effects of massive capital movements and large-scale conversions of dollars and sterling into gold.

3. How to meet the reserve needs of the low-income countries that hold, and prefer to hold, very small monetary reserves.

In considering these reserve problems, it must be borne

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In considering these reserve problems, it must be

in mind that the starting point in the solution of all reserve problems is to establish a strong pattern of world payments. This requires all countries to take positive action, consistent with their own monetary stability, to avoid a persistent deficit or surplus in their balance of payments.

Distribution of monetary reserves

At the end of 1961, the official monetary reserves of all countries, outside the Soviet bloc, amounted to $61.4 billion. The actual reserves of many countries were significantly larger than their official holdings of gold and foreign exchange. In these countries, a considerable amount of foreign exchange assets are held by deposit banks and these holdings of foreign exchange rise and fall with the balance of payments in much the same way as official reserves. Furthermore, in most countries the foreign exchange holdings of banks are available to the monetary authorities whenever this becomes necessary. On the other hand, it should be noted that gross monetary reserves do not take account of foreign exchange liabilities abroad, which are substantial in some instances and which are pressing in others. It should be noted that the gross monetary reserves of countries do not include their subscriptions to the resources of the International Monetary Fund nor their right to draw on these resources under prescribed conditions.

The official monetary reserves held by all countries outside the Soviet bloc have increased by $12 billion

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in the past ten years. At the same time, the foreign exchange holdings of deposit banks have increased by nearly $7 billion and the gold and foreign exchange holdings of the International Monetary Fund have been greatly enlarged. This increase in official monetary reserves occurred in a period when the value of world trade, as measured by exports, rose by 54 per cent. Nevertheless, with the increase of 25 per cent in official monetary reserves, the world economy is better provided now with the means to meet fluctuations in international trade and payments than it was in 1951. The reason for this is that the distribution of monetary reserves is now more appropriately related to the financing of international payments.

GROSS GOLD AND FOREIGN EXCHANGE RESERVES, 1951 AND 1956-61

(Billion U.S. dollars)

	1951	1956	1957	1958	1959	1960	1961	June 1962
United States	22.87	22.06	22.86	20.58	19.51	17.80	17.06	17.08
United Kingdom	2.37	2.28	2.37	3.11	2.75	3.24	3.32	3.44
Belgium	1.05	1.16	1.14	1.50	1.22	1.42	1.66	1.60
France	.62	1.18	.65	1.05	1.72	2.07	2.94	3.48
Germany	.52	4.12	5.11	5.73	4.53	6.74	6.54	6.23
Italy	.77	1.24	1.35	2.08	2.95	3.08	3.42	3.24
Netherlands	.55	1.04	1.01	1.47	1.34	1.74	1.72	1.80
Total, Common Market	3.52	8.74	9.26	11.83	11.77	15.05	16.27	16.35
Other Continental Europe	3.93	4.83	4.90	5.41	5.71	6.37	7.42	7.61
Japan	....	.94	.52	.86	1.32	1.82	1.49	1.62
Canada	1.83	1.95	1.84	1.95	1.88	1.84	2.06	1.82
Australia	1.13	.95	1.32	1.12	1.23	.84	1.35	1.26
New Zealand	.22	.20	.15	.19	.22	.18	.10	.16
South Africa	.39	.37	.29	.32	.43	.24	.39	.58
Latin America	2.98	3.68	3.82	3.11	3.00	2.94	2.84	2.60(e)
Sterling area, not listed above	5.70	6.01	5.42	5.16	5.51	5.50	5.47	5.30(e)
All other countries	4.11	3.88	3.54	3.68	3.73	3.89	3.64	3.80(e)
Total, all countries*	49.05	55.87	56.29	57.31	57.05	59.70	61.43	61.63(e)

* All countries outside Soviet bloc. Data are for end of period shown.

Source: International Financial Statistics, September 1962, p. 22.

The United States is the only great trading country that has had a very large decrease in reserves over this ten-year period. Its gold holdings were $22.9 billion at the end of 1951 and $17.1 billion at the end of 1961. Furthermore, its gold reserves are still decreasing at the rate of about $1 billion a year. In the meantime, the short-term and liquid dollar claims of other countries have increased substantially. The gold reserves of the United States are still very large, about 44 per cent of the total held by all countries outside the Soviet bloc. Its international capital position is strengthened by the large debts of other governments to the United States, by the enormous foreign investment of its nationals, and by the considerable assets that U. S. banks hold in the form of foreign claims. If the United States could eliminate its balance of payments deficit, there would be no reason to regard its gold reserves as inadequate, despite the fact that they are much smaller than they were ten years ago.

The countries of the Common Market -- Belgium, France, Germany, Italy and the Netherlands -- increased their reserves from $3.5 billion at the end of 1951 to $16.3 billion at the end of 1961. Some of these countries now have more reserves than they want. If there were an acceptable way of avoiding further large increases in their reserves, while avoiding domestic inflation, some of the Common Market countries would take such measures. The other Continental European countries have increased their reserves from $3.8 billion

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at the end of 1951 to $7.4 billion at the end of 1961. As a group, they have an adequate level of reserves.

The United Kingdom is the only large trading country of Western Europe whose reserves are clearly too small. While the $3.3 billion of gold and foreign exchange reserves of the United Kingdom at the end of 1961 were about $1 billion larger than they had been ten years before, they are not adequate. As one of the great trading and investing countries, as a reserve center with considerable short-term liabilities to the rest of the world, the United Kingdom needs larger reserves than any other country except the United States.

There is one group of countries that has not increased reserves as would have been expected. Japan is the sixth largest trading country. Its reserves, which were negligible in 1951, amounted to $1.5 billion at the end of 1961. But Japan has substantial short-term liabilities to foreign banks and its reserves are far below the needs of a country of its importance. Canada, Australia, New Zealand and South Africa had reserves of $3.9 billion at the end of 1961 compared with $3.6 billion ten years earlier. This moderate increase can be explained by special factors. In the Case of Canada, the exchange system in effect during this period involved a self-imposed limitation on the accumulation of reserves.

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New Zealand and South Africa, and in the rest of the world, excluding Japan, monetary reserves amounted to $12 billion at the end of 1961 compared with $12.8 billion at the end of 1951. This group of countries includes a few that have increased their reserves considerably. Most of these countries, however, held small reserves in 1951 and hold small reserves now. In nearly all of these countries, reserves are kept to a minimum in order to finance larger imports to sustain development programs. By the tests applied in the great trading countries, the reserves of most under-developed countries are too small for their needs. Nevertheless, these countries feel that they cannot afford to invest real resources in holding larger monetary reserves.

The distribution of monetary reserves bears significantly on the question of the adequacy of aggregate monetary reserves. If each country holds or could hold the amount of reserves it wishes to hold, total reserves must be regarded as adequate. For if the level of reserves were increased under such conditions, some countries that acquire additional reserves would regard them as excessive and would dispose of them by increasing imports relative to exports. This would transfer the additional reserves to countries that do not need them. The end result would be an excessive expansion in aggregate demand and an inflation in the world economy. It is not significant for this purpose that some countries underestimate the

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amount of reserves that would be appropriate for minimizing the adverse effects of fluctuations in their international payments. The fact is that if they held more reserves they would follow policies that would soon reduce them.

The I.M.F. and the growth of reserves.

Although the present level of gold and foreign exchange reserves is adequate, it does not follow that the growth of reserves in the future will be sufficient for an expanding world economy. As international trade and investment increase, there will be a need for larger reserves to finance fluctuations in international payments without imposing on countries the necessity of restricting imports or of contracting economic activity in order to avoid the temporary and recurrent deficits which are inevitable in a dynamic world economy. If international payments are kept reasonably well balance, so that large and persistent deficits are avoided, the average annual increment of monetary reserves can be smaller than the average annual increase in world trade and investment. It is not clear, however, that monetary reserves will continue to increase at the moderate rate required by an expanding world economy.

In the five years ending in 1961, the gross official reserves of gold and foreign exchange for all countries outside the Soviet bloc increased by $5.6 billion. Of this increase, about one-half was in the form of gold and the remainder in the form of foreign exchange. For countries other than the United States,

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the increase in gross official holdings of gold and foreign exchange in this five-year period was much larger -- $10.6 billion. Of the increase of reserves of these countries, over $5 billion came from a reduction of the gold reserves of the United States and $3.1 billion from an increase in foreign official holdings of U.S. dollars. In fact, there was a small reduction of foreign exchange reserves in currencies other than the U. S. dollar.

Obviously, this increase cannot be matched in the next five years without causing serious difficulties in the world economy. The United States cannot reduce its own gold reserves much further or sustain another sharp rise in dollar liabilities abroad without seriously weakening its own reserve position. If U.S. gold reserves do not fall and foreign dollar holdings do not rise, the increase of reserves in the future will have to be met almost entirely from newly-mined gold. Gold production during the past five years amounted to $5.6 billion of which $3 billion went into the monetary gold stock of all countries and international institutions. The annual increment of monetary gold is only a little over 1 per cent of gross gold and foreign exchange reserves. Over the long run, this is not sufficient to meet the reserve needs of an expanding world economy.

The key problem is to find some way to supplement the increase in monetary gold with an adequate increase of reserves in other forms. The role of foreign exchange in the growth of monetary

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reserves is likely to be more limited in the future than it has been in the past 20 years. The United States is not in a position to provide more than a modest increase in the dollar holdings of foreign official institutions unless it increases its own gold holdings almost proportionately. There has been virtually no change in foreign holdings of sterling over the past ten years. It is conceivable that the emergence of new reserve centers will enable countries to accumulate foreign exchange reserves in other currencies. This is, at best, a slow and difficult process. The fact is that future reserve needs will have to be largely met in some other form in addition to gold and foreign exchange. This can best be done through the International Monetary Fund.

The Fund was established for the purpose of providing a common reserve of gold and currencies to help meet the temporary balance of payments deficits of its members. The record of the past 15 years is eloquent testimony on the remarkable achievements of this institution. Its sales of currencies to members amounted to $6.7 billion to the end of July, 1962. The resources available under stand-by agreements currently in effect amount to an additional $1.9 billion. These transactions and stand-by agreements have been and are of incalculable help to the 45 countries that have made such use of the Fund's resources. In turn, member countries have shown a high sense of responsibility in meeting their financial

reserve is likely to be more limited in the future than it has been in the past 20 years. The United States is not in a position to provide more than a modest increase in the dollar holdings of foreign official institutions unless it increases its own gold holdings almost proportionately. There has been virtually no change in foreign holdings of sterling over the past ten years. It is conceivable that the emergence of new reserve centers will enable countries to accumulate foreign exchange reserves in other currencies. This is, at best, a slow and difficult process. The fact is that future reserve needs will have to be largely met in some other form in addition to gold and foreign exchange. This can best be done

obligations to the Fund. It should be noted that while the Fund was undertaking these vast financial operations, its members were being helped and encouraged to achieve the objectives of exchange stability and currency convertibility.

The role of the Fund in the world economy has been much greater than its founders had foreseen at Bretton Woods. The Fund cannot stand aside while the world gropes for other means to assure an adequate and orderly growth in monetary reserves. As a practical matter, its enormous resources are no longer supplementary reserves, but an important constituent of the active reserves of its members. The Fund would be far more effective in achieving its objectives if it recognized the reality that it has become one of the major reserve centers. Its methods of operation should be adapted gradually to performing the functions of a reserve center. This can be done within the framework of the present statutes of the Fund.

The most important step that can be taken to meet future reserve needs is to integrate the quotas of members of the Fund with their working reserves. This means that members would be able to include their gross I.M.F. position in a statement of their reserves. More important, it means that members should be able to draw on their quotas, within the annual limit of 25 per cent, without special approval of the Fund. The Fund has already made great progress in this direction. It will be encouraged to proceed much

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further toward this goal if members of the Fund demonstrate that they are prepared to use their quotas as if they are truly reserves-- to be drawn down to meet their temporary payments deficits, but to be restored promptly so as to be available for use when they have payments deficits again. With such a policy on use of Fund resources, and with periodic increases in quotas as needed, there would be no reason to fear that monetary reserves would not grow at a rate appropriate for an expanding world economy.

Problem of the reserve centers

The great dependence of the world economy on foreign exchange to assure adequate monetary reserves has created a difficult problem for the reserve centers-- the United States and the United Kingdom. At the end of 1961, gross official monetary reserves consisted of $38.9 billion in gold and $22.6 billion in foreign exchange. About 80 per cent of the foreign exchange reserves were in the form of U.S. dollars and sterling. The remaining foreign exchange reserves were in the form of official holdings of French francs and other currencies and in deposits at the Bank for International Settlements.

The dependence of the world economy on dollars and sterling as reserves is even greater than indicated by these figures. Excluding the United States and the United Kingdom, official holdings of gold of all other countries outside the Soviet bloc amounted to about $19.2 billion at the end of 1961. Official holdings

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The dependence of the world economy on dollar and sterling as reserves is even greater than indicated

United Kingdom, official holdings of gold of all other countries outside the Soviet bloc amounted to about $40.5 billion at the end of 1961. (Official holdings

of dollars and sterling amounted to $18.4 billion, excluding the dollar holdings of the United Kingdom. Furthermore, apart from official reserves, there were substantial balances of dollars and sterling of commercial banks and other private holders abroad. These enormous dollar and sterling claims expose the United States and the United Kingdom to the danger of a serious depletion of their reserves if there should be a large outflow of such balances or their conversion into gold at a time of economic difficulty or political crisis.

Apart from the reserve centers, the establishment of currency convertibility in many of the great trading countries has led to much freer movements of liquid funds from one financial center to another. Such freedom of capital movements is desirable to provide a pool of liquid resources that can be used to finance international trade and payments throughout the world economy. Nevertheless, freedom of capital movements does create the possibility of a very large capital outflow, for interest arbitrage or for exchange speculation, in a period of economic adversity or political uncertainty. To avoid the necessity of re-imposing controls, it is desirable for countries with convertible currencies to have access to special resources to finance such capital movements until the outflow offunds can be reversed.

Fortunately, the great trading countries have recognized the need to deal with the problem of massive

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capital movements and large-scale conversion of reserve currencies into gold. They have recently agreed to provide the International Monetary Fund with special resources amounting to $6 billion that can be used to extend temporary assistance, under prescribed conditions, to avoid the drain on reserves resulting from such capital movements and from the conversion of dollars and sterling into gold. With these special resources, the reserve centers will be in a better position to maintain the equivalence of their currencies and gold at the par values they have agreed with the Fund. It would be a mistake, however, to assume that the provision of these special resources has obviated the need for positive action by the reserve centers to maintain the strength and value of their currencies.

In the last analysis, there is only one way in which to assure continued confidence in dollars and sterling. That is through the maintenace of a strong payments position by the United States and the United Kingdom. In fact, there is no way in which these countries can function effectively as reserve centers unless they keep their balance of payments in order. There is no reasonable basis for the view that the payments difficulties of these countries have been in any way caused by a world shortage of reserves. In a period in which the Continental European countries have accumulated enormous reserves, the failure of the United Kingdom to strengthen its reserves correspondingly

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must be attributed primarily to its relatively weaker competitive position. The payments difficulties of the United States are basically due to the exigencies of its position as the leader of the Western countries. This has imposed on the United States enormous costs for the maintenance of troops abroad and for foreign aid. A more equitable sharing of these burdens by other high-income countries would facilitate the restoration of the U.S. balance of payments. Needless to say, every effort must be made by the United States to strengthen its international competitive position by holding down prices and costs.

Reserve problem of the underdeveloped countries

The discussion above has brought out the fact that most of the underdeveloped countries do not hold sufficient reserves to meet the recurrent fluctuations in their international payments. In 1951, the underdeveloped countries held reserves of $12.8 billion. At the end of 1961, however, their reserves were less than $12 billion. In the intervening period, the reserves of the underdeveloped countries have risen and fallen with their exports. As imports respond promptly to an increase in exports, their reserves do not rise substantially even when they have large foreign exchange receipts. In fact, very few of the underdeveloped countries hold more than a bare minimum of reserves. As a consequence, when their exports fall because of a deterioration in world markets, the underdeveloped countries are compelled to reduce their imports sharply.

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The commodities for which price stabilization arrangements can be made are limited in number. Furthermore, even with such commodity agreements it would not be possible to avoid relatively large cyclical fluctuations in the prices of primary products. The fluctuations in export receipts of most underdeveloped countries will unfortunately continue to be relatively large. At the same time, because of their urgent need for capital, the low-income countries are reluctant to hold reserves to the extent necessary to offset such large fluctuations in their export receipts. The International Monetary Fund could be, and increasingly has been, a source of supplementary reserves for the underdeveloped countries. But their quotas are not, and probably cannot be, sufficient to meet the payments deficits that confront them in a period of weakness

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in world markets for primary products.

During the past ten years a number of proposals have been made to deal with the difficulties arising from fluctuations in the prices of primary products. The United Nations has issued a number of reports recommending measures to compensate countries exporting primary products for a decline in the prices of such commodities. The Organization of American States has also made studies of the commodity problems of Latin America. More recently, the Alliance for Progress has recommended the establishment of a fund for the stabilization of export receipts of low-income countries dependent on exports of basic commodities. This report has recently been presented by the United States to the Committee on International Commodity Trade and it is now being considered in Rome.

Under this plan, an Export Receipts Stabilization Fund would be established, either as a subsidiary of the International Monetary Fund or as an independent institution. The Export Receipts stabilization Fund would have resources provided by both the high-income and the low-income countries. However, only the low-income countries would be eligible to make use of the resources of the institution. It is not feasible, whatever its merits, to provide aid to the United States, Canada, Australia and other high-income countries when their exports of primary products decline. On the other hand, it is feasible to secure sufficient resources to provide aid for the low-income countries when their

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The principal provisions of the plan for an Export Receipts Stabilization Fund can be summarized briefly as follows: Whenever the export receipts of a low-income country fall below the average of the three preceding years, it would be entitled to secure credits from the institution, on a virtually automatic basis, to the extent of two-thirds of the short-fall in its exports. When the export receipts of a country indebted to the institution rise above the average of the three preceding years, two-thirds of the excess would be used to repay the export receipts stabilization credits it previously received. When any credit has been outstanding three years, one-half of the balance would have to be repaid in the fourth year and the remainder in the fifth year, even if a country's exports had not increased.

There are a number of other provisions that are intended to assure the equitable use of the resources of the institution. No country can secure export receipts stabilization credits in excess of 20 per cent of the average of its exports in the three preceding years. Whenever a country is using the resources of the institution in a manner not consistent with its purposes, the country may be declared ineligible to receive export receipts stabilization credits. Furthermore, if the institution finds that its resources may not be sufficient to meet all requests for export receipts stabilization credits, it may ration the amount of credits it extends. Notwithstanding these limitations, a country

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could apply for additional special credits if it finds that the amount of export receipts stabilization credits to which it is entitled does not properly reflect the impact on its economy of the decline in its exports.

This is essentially a plan to deal with the reserve problem of the underdeveloped countries. Needless to say, it would not achieve its purposes if it merely resulted in a further reduction of the independent reserves held by the low-income countries or if export receipts stabilization credits were to induce a corresponding reduction of the drawings of low-income countries on the International Monetary Fund. The plan is no solution to the basic commodity problems of the raw materials exporting countries. On the other hand, there is no reason why it should hamper international commodity agreements in any field in which such cooperation is possible. Within its limited scope, the Export Receipts Stabilization Fund could be of great practical help to the low-income countries in minimizing the adverse effects of large fluctuations in their export receipts.

Reserves and the pattern of payments

It is impossible to separate the problems of monetary reserves from international payments. Reserves are held to meet fluctuations in exchange receipts, so that large reductions in imports can be avoided in periods of temporary adversity. Furthermore, reserves enable a country to maintain financial policies suited to its domestic economic situation

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and that are, for a time, independent of its balance of payments. The assumption that domestic financial policies can be made completely independent of the balance of payments, if monetary reserves are large enough, is mistaken. In most instances, balance of payments deficits are indicative of inflationary forces that would disrupt the domestic economy if they were permitted to persist. Where balance of payments difficulties are attributable to other forces, the persistence of deficits would have a deflationary effect on the economy. The fact is that in order to achieve their objectives of high level of output at stable prices, countries must avoid large and persistent balance of payments deficits.

In an environment of expanding world trade, in which the great trading countries avoid excessive surpluses and excessive deficits in international payments, the world economy would get along very well with the present level of monetary reserves and with a moderate rate of growth of reserves in the future. The importance of appropriate financial policies in the deficit countries has already been emphasized. It is also important to have appropriate financial policies in the surplus countries. Where a country has a large and persistent surplus in its balance of payments, it may indicate that wages are too low for productivity or interest rates are too high for savings. The surplus countries of Europe are natural capital exporting countries. It is essential that their interest rates be brought into proper relationship with those of the

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So far as possible, and in all cases where a deficit country is free of inflation, it is desirable to restore the balance of payments by expanding exports rather than by restricting imports. This places a special obligation on countries that have a large and persistent balance of payments surplus to reduce tariffs and other barriers to trade. It is understandable that surplus countries should hesitate to follow easier financial policies for fear of their inflationary effects. That is all the more reason why surplus countries should follow trade policies that will encourage imports. Such policies are particularly appropriate for the Common Market countries at this time.

With proper financial and trade policies, balance of payments surpluses and deficits will largely reflect cyclical and fortuitous fluctuations in international trade and investment. Such balance of payments difficulties will ordinarily correct themselves or can be quickly corrected by minor changes in wage and price policies. In a world economy with such a pattern of payments there is no reason to fear a general shortage of monetary reserves. The reserve problems of the financial centers and of the underdeveloped countries are special cases requiring special facilities. These problems can be met and are being met through international cooperation. They do not require a massive increase in monetary reserves.

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FOREIGN EXCHANGE POLICY AND ITS RELATIONSHIP TO DOMESTIC MONETARY POLICY

1. In the discussion of domestic monetary policy it was stated that the maintenance of a stable exchange rate should be one objective of monetary policy and that this objective is ordinarily consistent with the attainment of the other objectives of monetary policy on production and employment and approximate stability of prices. A stable exchange rate in this discussion refers to a parity that is agreed with the International Monetary Fund and that is suitable to the international economic position of the country. Such a parity must be maintained without resort to restrictions on current international transactions, except with the approval of the Fund; and the currency must be convertible in accordance with the provisions of the Fund.

Appropriate balance of payments

2. The maintenance of a stable exchange rate depends upon having an appropriate balance of payments. There is no way in which a country can sustain a large and persistent deficit in the balance of payments on current and normal capital account without ultimately undermining the stability of its exchange rate or necessitating the imposition of exchange restrictions. Domestic monetary policy must, therefore, take into consideration the importance of maintaining an appropriate balance of payments; and this must be done without impairing the effectiveness of monetary policy in achieving its other objectives.

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3. An appropriate balance of payments for a country with a fixed parity is one that enables it, over an average of good years and bad, to meets its payments, including ordinary capital outflow out of its receipts from current transactions and ordinary capital inflow, without compelling it to keep economic activity below a desirable level or to restrict imports merely for the purpose of avoiding a deficit in the balance of payments.* This definition should be further refined to provide that an appropriate balance of payments should enable a country to add a sufficient amount of gold and foreign exchange to its monetary reserves. To enable all countries to increase their monetary reserves to the extent called for by an appropriate balance of payments, the growth in world reserves would have to be at an adequate rate.

4. One task of domestic monetary policy is to prevent the emergence of conditions that will lead to a large and persistent deficit or surplus in the balance of payments. Ordinarily, the same policy will also be required for maintaining a high level of production and employment in an environment of approximate price stability. In a world economy in

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which other great trading countries are not suffering frominflation or deflation, a large and persistent balance of payments deficit or surplus indicates that economic policy and monetary policy are not properly related to a country's real international economic position. Under these conditions, a large and persistent balance of payments deficit is likely to be the consequence of excessive aggregate demand or of a steady rise in prices and costs. On the other hand, a large and persistent balance of payments surplus is likely to indicate either an inadequate level of production and employment or wage rates that are too low for productivity and interest rates that are too high for the savings of a country.

5. When other great trading countries have a large and continuing inflation or permit their economy to suffer from deep and prolonged depression, it is not possible for one country to prevent an inappropriate balance of payments solely through its own monetary policy. Under such conditions it must expect other countries to adjust their policies to the conditions called for by a world economy under a regime of fixed parities. The responsibility for correcting such a disruption in the pattern of international payments rests with the country that is generating inflation or deflation. The great difference between fixed parities under the gold standard and under the International Monetary Fund is the consensus among the great trading countries that they have a common interest in preventing the spread of inflation or

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deflation from country to country because this would undermine the functioning of the world economy.

6. A country that maintains a high level of production and employment and approximate stability of prices could, nevertheless, have a persistent surplus or deficit in its balance of payments. This could be due to the fact that the demand for its exports relative to its imports may have changed or that the capital inflow or outflow relative to its own deficiency or excess of domestic savings may have changed. In such a case the obligation to correct the balance of payments is not one that falls entirely on either the surplus country or the deficit country. It will be necessary for both surplus and deficit countries to make minor adjustments in wage and interest policy. In the deficit country, wage rates will have to increase somewhat less than the average increase of productivity; in the surplus country, wage rates will have to increase somewhat more than the average increase of productivity. In addition, or possibly as an alternative, interest rates may have to be reduced in the surplus countries and raised in the deficit countries.

7. When a large and persistent balance of payments surplus or deficit has persisted for some time, it may become impossible to adjust wages to restore a proper relationship of prices and costs. Under the Articles of Agreement of the International Monetary Fund, the obligation to maintain stable exchange rates does not require countries to undertake

deflation from country to country because this would undermine the functioning of the world economy.

6. A country that maintains a high level of production and employment and approximate stability of prices could, nevertheless, have a persistent surplus or deficit in its balance of payments. This could be due to the fact that the demand for its exports relative to its imports may have changed or that the capital inflow or outflow relative to its own deficiency or excess or domestic savings may have changed. In such a case the obligation to correct the balance of payments is not one that falls entirely on either the surplus country or the deficit country. It will be necessary for both surplus and deficit countries to make minor adjustments in wage and interest policy. In the deficit country, wage rates will have to increase somewhat less than the average increase of productivity; in the surplus country, wage rates will have to increase somewhat more than the average increase of productivity. In addition, or possibly as an alternative, interest rates may have to be reduced in the surplus countries and raised in the deficit countries.

7. When a large and persistent balance of payments surplus or deficit has persisted for some time, it may become impossible to adjust wages to restore a proper relationship of prices and costs. Under the Articles of Agreement of the International Monetary Fund, the obligation to maintain stable exchange rates does not require countries to undertake

an offsetting deflation or inflation that would involve a decrease in production and employment or a sharp rise of prices. Instead, a country may propose to change the parity of its currency if this is necessary to restore its balance of payments. While a change in parity may be the best method of correcting an inappropriate balance of payments, it must be recognized that the necessity for an exchange rate adjustment is evidence that monetary policy has not succeeded in achieving the objective of stable exchange rates.

Cyclical fluctuations and the balance of payments

8. Under ordinary conditions, the balance of payments of a country will vary over the course of a business cycle. For a country that is not ordinarily an importer or exporter of capital, the current account balance of payments will show a deficit in a period of cyclical expansion and a surplus in a period of cyclical contraction. For a country exporting or importing capital, the overall balance of payments on current and capital account may follow the same pattern. Such cyclical movements are entirely consistent with an appropriate balance of payments, provided that the deficit during the period of expansion is fully offset by the surplus in the course of a business cycle.

9. There is no reason for correcting ordinary cyclical fluctuations in the balance of payments. They help to minimize cyclical fluctuations in production and employment. In any case, a cyclical

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9. There is no reason for connecting ordinary cyclical fluctuations in the balance of payments. They help to minimize cyclical fluctuations in production and employment. In any case, a cyclical

policy that is designed to attain the domestic objectives of monetary policy will ordinarily have a helpful effect on the balance of payments. In a period of cyclical expansion, the monetary authorities will restrain credit expansion when its effect in raising prices and costs is greater than its contribution to expanding production and employment. This will, at the same time, limit the cyclical deficit in the balance of payments and prevent an excessive rise in relative prices and costs. Similarly, in a period of cyclical contraction, the monetary authorities will encourage credit expansion in order to avoid prolonged unemployment. This will limit the cyclical surplus in the balance of payments and prevent an excessive fall in relative prices and costs.

10. When a country has a large surplus in its balance of payments during a period of cyclical expansion or a large deficit in its balance of payments during a period of contraction, this is evidence that relative prices and costs have become distorted. Monetary policy may then have to be adjusted to induce wages to rise slightly more or less than the average increase of productivity. If wage rates are reasonably responsive to balance of payments conditions, it should be possible to make the adjustment in relative prices and costs without adversely affecting production and employment.

11. There may be fortuitous conditions that cause a balance of payments deficit. This may be

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the result of such special circumstances as a crop failure, the need to secure extraordinary imports for stock during a period of disrupted international trade, or a temporary outflow of short-term funds. It is preferable not to adjust monetary policy to fortuitous developments, for there is no necessary correlation between such changes in the balance of payments and the domestic economic situation. A monetary policy that is intended to offset a fortuitous balance of payments deficit could depress production and employment. A fortuitous deficit in the balance of payments should be met out of reserves, or if reserves are not adequate, out of foreign credits.

12. The basic principle that should guide domestic monetary policy is that special measures are not necessary to deal with ordinary cyclical fluctuations in the balance of payments or a fortuitous deficit in the balance of payments. Instead, the monetary authorities should rely on the use of reserves for this purpose. It is an essential aspect of a policy of exchange stability that a country should hold reserves that are adequate to meet cyclical and occasional fortuitous deficits in the balance of payments. This requires reserves to be accumulated in the contraction phase of the cycle; and it requires a balance of payments surplus over the course of a cycle to enable a country to add to its reserves. The ability to reconcile the domestic objectives of monetary policy with foreign exchange stability therefore depends, in considerable part,

the result of such special circumstances as a crop failure, the need to assure extraordinary imports for stock during a period of disrupted international trade, or a temporary outflow of short-term funds. It is preferable not to adjust monetary policy to fortuitous developments, for there is no necessary correlation between such changes in the balance of payments and the domestic economic situation. A monetary policy that is intended to offset a fortuitous balance of payments deficit could depress production and employment. A fortuitous deficit in the balance of payments should be met out of reserves, or if reserves are not adequate, out of foreign credits.

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on a satisfactory system for providing monetary reserves to meet the needs of an expanding world economy.

Interest rates and the balance of payments

13. In the past few years, there has been a tendency for relatively large amounts of short-term funds to move from country to country. For some countries such capital movements have been a seriously disrupting factor in the balance of payments. In 1960 and 1961, the recorded outflow of private short-term funds of U.S. nationals amounted to $2.8 billion. As errors and omissions in the two years amounted to $1.2 billion, there must have been a considerable unrecorded outflow of U.S. private short-term funds. To some extent, these movements of liquid funds were speculative in character, reflecting fears of depression or exchange depreciation. There is no way to avoid such speculative capital movements except by maintaining a strong balance of payments and by moderating the downward cyclical movements in business activity.

14. After allowing for speculative capital movements, it appears that there are large transfers of liquid funds in response to international differences in interest rates. Nevertheless, the magnitude of the problem may not be as great as is sometimes thought, probably for the United States and possibly for some other countries. The large increase in the foreign loans of U.S. banks, amounting to $2.8 billion from

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1959 to 1961, was due to special factors. There has already been a slackening of the capital outflow of U.S. banks in the first half of 1962, with a net increase of only $200 million in outstanding foreign credits. Even so, short-term capital movements will remain an important element in international payments in the future.

15. There are several reasons for the recent increase in transfers of liquid funds between financial centres. The basic reason is the greater economic strength and stability of the countries of continental Western Europe. Their payments surplus, the convertibility of their currencies, and their large monetary reserves have made the holding of short-term funds in these countries safe and attractive. Furthermore, with the restoration of flexible credit policies, short-term interest rates fluctuate more readily in response to domestic business conditions and international differences in short-term interest rates are consequently much larger than formerly. This raises some questions regarding the relationship of interest rates to the balance of payments and the resulting limitation on the use of interest rates for the purpose of influencing the domestic economy.

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of payments deficit. From the point of view of the world economy, the adjustment of the balance of payments through a strengthening of the trade position of a country is far preferable to an inflow of short-term funds. A shift of trade is likely to be gradual and its effects tend to be spread over the entire trading world. An inflow of short-term funds, on the other hand, will be concentrated on one or more financial centres that may have payments problems of their own. Nevertheless, there are occasions when a country cannot restore its balance of payments at the time and to the extent required except by raising short-term interest rates to attract a large capital inflow.

17. A country has the responsibility of minimizing the adverse impact on other countries of a policy of high interest rates. It should avoid the emergence of a balance of payments deficit of a magnitude that requires drastic remedial measures by taking prompt action to keep its balance of payments in order. When a rise in interest rates becomes necessary, it should be limited as far as possible and a more appropriate relationship of interest rates to those in other financial centres should be restored as soon as possible. Finally, it should be recognized that this is an international problem and special facilities for assistance should be available to countries whose balance of payments is seriously disturbed by the transfer of liquid funds from one financial centre to another.

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18. The greater sensitivity of liquid funds to international differences in interest rates presents a serious dilemma for domestic monetary policy. In a period of inadequate production and employment, an easing of credit policy and a reduction of interest rates is called for to limit the cyclical contraction and to facilitate recovery. On the other hand, if lower short-term interest rates were to induce a large capital outflow, the monetary authorities might be hampered in their efforts to achieve the domestic objectives of monetary policy. This is an instance in which there could be a conflict between the domestic objectives and the balance of payments objectives of monetary policy. Some means must be found of avoiding or minimizing this potential conflict.

19. The basic problem is not to prevent any movement of liquid funds from one financial centre to another, but to avoid large and disruptive movements of such funds. A country with an appropriate balance of payments would ordinarily have a surplus in a period of recession. A small outflow of liquid funds in response to lower short-term interest rates would not be unwelcome if the outflow did not exceed the normal cyclical improvement in the balance of payments. The difficulty arises when the outflow of liquid funds is on such a scale that it dwarfs the normal cyclical improvement in the balance of payments and creates a large deficit in the over-all balance of payments. It is necessary to retain a flexible monetary policy and, at the same time, to avoid massive and disruptive capital movements.

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20. The solution to the problem may be found in moderating cyclical changes in interest rates. Prior to the restoration of a flexible monetary policy in 1951, short-term interest rates on very liquid investments were at 1 per cent a year or less in virtually all of the great trading countries except France and Germany. Even after 1951, a number of countries followed the practice of keeping short-term interest rates very low in periods of recession. In the United States, for example, the yield on three-month Treasury bills was less than 1 per cent in the recessions of 1954 and 1958. The greater sensitivity of international capital movements to differences in short-term interest rates has compelled countries to avoid unduly low rates even during recession. In 1960-61, for example, the lowest average monthly yield on three-month Treasury bills in the United States was about 2¼ per cent.

21. Without discussing the precise role of short-term interest rates in achieving the objectives of monetary policy, it is apparent that a 2¼ per cent Treasury bill yield can have much the same effect on the economy as a 1 per cent yield while sharply narrowing the inducement to transfer liquid funds abroad. Fortunately, it has been possible to maintain this Treasury bill yield in the United States while keeping the availability of credit about as easy as it had been in previous recessions. Furthermore, during the current expansion of the U.S. economy it has been possible to keep the yield on Treasury bills below 3 per cent -- lower than it had been in the expansions

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of 1954-57 and 1958-60. The policy of avoiding very low short-term interest rates has not stopped the outflow of liquid funds; but it has kept the outflow down to manageable amounts.

International co-operation on capital movements

22. It is now generally recognized that it would be desirable to have international co-operation in avoiding or offsetting disruptive movements of short-term funds. One suggestion is to have the great trading countries follow monetary policies that would remove or minimize the inducement to transfer funds from one country to another. If such co-operation requires the avoidance of interest rate differentials, it is not practical. Such an approach to the problem would necessitate the virtual abandonment of monetary policy as a means of acting on the domestic economy. On the other hand, if such co-operation results in the narrowing of interest rate differentials by avoiding extremely high and extremely low short-term interest rates, it can be very helpful in limiting short-term capital movements. In fact, there is now close co-operation among the leading central banks on short-term interest rates.

23. The well-being of the world economy will be better served if the great trading countries follow an independent and flexible monetary policy, properly related to their domestic economic situation and their long-run payments position, provided that this policy keeps cyclical changes in short-term interest rates

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within a reasonably moderate range. To have an independent and flexible monetary policy, without extremely high or low short-term interest rates, other measures must be used to restrain home demand in a period of boom and to stimulate home demand in a period of recession. The monetary policy of a country will be more effective at home and less disturbing abroad if it is part of a comprehensive financial programme designed to maintain a high level of production and price stability as well as a strong balance of payments.

24. Such national monetary policies would still permit short-term capital movements in response to interest rate differentials. With the narrower range of short-term interest rates, the international flow of liquid funds should ordinarily be moderate in magnitude and helpful in maintaining a balanced pattern of international payments. Under such conditions, countries could usually be expected to finance an outflow of short-term capital out of their own reserves. There will be times, however, when a conjuncture of basic payments difficulties, a recession, and wider interest rate differentials will induce a larger outflow of liquid funds. If this occurs, it would be better to permit the temporary outflow of capital than to force an undesirable adjustment of interest rates that might have adverse effects on the domestic economy. The great trading countries have recently completed arrangements to provide special resources, through the International Monetary Fund, to finance a temporary

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outflow of capital. With these special resources, the members of the Fund should be able to meet any balance of payments deficit that is likely to result from short-term capital movements.

25. The international relationship of long-term interest rates involves more complex problems. On the whole, differences in long-term interest rates among the great trading countries have tended to become narrower in recent years. Nevertheless, there are natural capital exporting countries in Western Europe with a strong balance of payments whose long-term interest rates are substantially higher than those in the United States. It would, of course, be desirable to narrow these international differences in long-term interest rates. Because of the high level of unemployment in the United States, it is important to achieve this by a lowering of European interest rates rather than a raising of American interest rates. Dr. Holtrop, president of the Netherlands Bank, has proposed that international co-operation among central banks be extended to the field of long-term interest rates. Such co-operation could be helpful in securing a more rational distribution of the sources of long-term international capital among all the natural capital exporting countries.

E. M. Bernstein

Washington, D.C.
September 6, 1962.

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THE ROLE AND OBJECTIVES OF DOMESTIC MONETARY POLICY.

I. Objectives of Monetary Policy

1. The objectives of domestic monetary policy are not the same for all countries. In a high-income country, primarily industrial in character, the objectives of domestic monetary policy may be summarized as follows:

(1) To maintain a high level of production and employment and to minimize cyclical fluctuations in economic activity;

(2) To maintain approximate stability in the wholesale price level of domestically produced industrial goods;

(3) To maintain stable exchange rates, except as a change in parity is necessary to avoid a large and persistent imbalance in international payments.

Production and employment

2. The primary objective of monetary policy is to facilitate the maintenance of a high level of production and employment. To achieve this objective, aggregate demand must be adequate to utilize the productive resources of the economy, particularly the labor force. One aspect of this objective is to minimize the cyclical fluctuations in production and employment that involve a recurrent fall in production and employment during the contraction phase of the cycle. Beyond that, it is desirable to facilitate the movement of productive resources from the declining to the rapidly expanding sectors of the economy. More recently, emphasis has been placed on encouraging a high rate of growth of production.

S M D (UTD.)

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Introduction and Qualifications

2. The primary objective of monetary policy is to facilitate the maintenance of a high level of production and employment. To achieve this objective, aggregate demand must be adequate to utilize the productive resources of the economy, particularly the labour force. One aspect of this objective is to minimize the cyclical fluctuations in production and employment that involve a recurrent fall in production and employment during the contraction phase of the cycle. Beyond that, it is desirable to facilitate the movement of productive resources from the declining to the rapidly expanding sectors of the economy. More recently, emphasis has been placed on encouraging a high rate of growth of production.

3. In a high-income economy, there is a tendency for economic activity to fluctuate in a more or less regular cycle. If the cyclical decline in production and employment could be reduced during recession, and the period of recession shortened, the average level of production and employment would be raised considerably. Cyclical fluctuations in economic activity are largely due to the fact that certain sensitive sectors of expenditure tend to rise relative to the gross national product in periods of expansion and to fall relative to the gross national product in periods of contraction. These sensitive sectors are consumer durable goods, residential construction, fixed business investment, and additions to business inventories.

4. Although the sensitive sectors of the economy are larger relative to the gross national product than they were in the past, the amplitude of cyclical fluctuations has tended to become smaller. The principal reason for this is that other economic measures have tended to dampen the concomitant changes in aggregate demand that accompany the cyclical fluctuations in the sensitive sectors. The most important of these stabilizing factors is undoubtedly the social security system--primarily unemployment insurance. Fiscal policy, particularly public expenditures, has also come to be used to a greater extent as a contra-cyclical device.

5. Monetary policy can be a helpful instrument in moderating cyclical fluctuations. All of the sensitive sectors of the economy are to some extent

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5. Monetary policy can be a natural instrument in moderating cyclical fluctuations. All of the sensitive sectors of the economy are to some extent

financed through credit. The tightening of credit in a period of excessive expansion can, therefore, compel some reduction in demand in these sectors. Similarly, it is possible to some extent to limit a cyclical contraction and to induce a resumption of the expansion by easing credit. The manner in which credit policy operates on the level of business activity will be discussed later.

6. There is a question of the extent to which persistent unemployment can be dealt with through credit policy. In every dynamic economy, there are some industries expanding at a better than average rate and others that are declining. Monetary policy can help to maintain a high and efficient level of production by facilitating the expansion of the industries that are growing. For this purpose, it is necessary to induce the movement of labor from the declining industries to the growing industries. Aggregate demand should be kept high enough to provide opportunities for increased employment in the growing sectors, but not so high as to obviate the need for a transfer of resources from the declining sectors. This may involve some unemployment in the declining industries. While it is not desirable to choke off expansion on the first signs of full employment in a few sectors, it is a mistake to tolerate inflation in order to offset the immobility of some productive resources. In determining the appropriate level of aggregate demand, the monetary authorities must, therefore, take cognizance of the effect of expansion on prices and the balance of payments

as well as on total production and employment.

7. The problem of maintaining adequate aggregate demand is not merely one of offsetting ordinary cyclical fluctuations in the sensitive sectors of the economy. Over longer periods of a decade or more, there may be a slowing down in the growth of aggregate demand. Such a change has occurred, and usually occurs, after a great war. In the United States, the postwar period started with a large accumulation of demand for consumer durable goods, residential construction and plant and equipment of all of which a considerable deficiency, relative to postwar needs, had developed during the great depression of the 1930's and the second World War. This exceptional demand was gradually met, with postwar peaks in absolute output or in output relative to trend reached in these sectors at various times between 1955 and 1959. The failure of these sectors to continue to expand at their previous rates is the principal reason for the slowing down of the growth of production in the United States in the past six or seven years.

8. After an exceptionally high level of demand for durable goods and construction has been satisfied, there is an interval in which demand is less than normal relative to total personal incomes and the gross national product. Within a few years, it may be expected that replacement needs will rise and the growth population and income will once more require a larger expansion in the economy's stock of durable goods and construction. It seems to me that this is already happening in the demand for automobiles. Within a few

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years, it will begin to happen to residential construction and to plant and equipment. This pattern of exceptionally high demand followed by less than normal demand, typical of every postwar period, creates new economic problems. While it was necessary to restrain excessive demand, which was exerting inflationary pressures in the early postwar period, it is now necessary to encourage adequate demand to avoid unemployed resources. In time the problem will be met by the recovery of demand for durable goods and construction and by the growth of other sectors of the economy. In this interval, however, it is essential to use monetary and economic policy to encourage an adequate level of aggregate demand.

9. A great deal of stress has recently been placed on the rate of economic growth. The average annual rate at which the output of an economy grows depends in part on the improvement of productive efficiency in each specific industry and in part on the shift of production from lower output sectors to higher output sectors. In general, the high output sectors are the durable goods and construction industries. The low output sectors are agriculture and certain service industries. The shift to high output production is primarily a response to consumer preference. Within limits, it is possible for Governments to facilitate such a shift, although monetary policy is not an effective means of changing the structure of the economy. Specific improvement in productive efficiency, industry by industry, is largely a matter of technology. It is possible, however, to

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encourage a wider use of the most efficient methods of production by reducing the cost of undertaking new investment.

10. The rate of economic growth in the United States and Canada in recent years has been much lower than in continental Western Europe and Japan. In these countries, too, the rate of economic growth will slow down after the exceptional postwar demand has been met, although it will probably remain higher than in the United States and Canada. One reason is that their pattern of output is shifting toward the high output industries already characteristic of the United States and Canada. Furthermore, the present differential in productivity, industry by industry, between the United States and Canada on the one hand and Western Europe and Japan on the other hand, cannot continue indefinitely. With their highly developed technology, skilled labor and enterprising management, their productive efficiency will in time come nearer to that of the United States and Canada. The important objective is to maintain a high level of production and employment, encouraging the growth of the efficient sectors of the economy. It is not of fundamental significance that the average annual rate of growth of total output may be somewhat lower in the United States and Canada than in Western Europe and Japan.

Stability of prices

11. The appropriate price policy for a high-income country, primarily industrial in character, is

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Stability of prices

15. The appropriate price policy for a high-income country, primarily industrial in character, is

to maintain approximate stability in the wholesale price level of domestically produced industrial goods. The view that monetary policy should be directed toward achieving approximate stability in consumer prices seems to me untenable. Such a policy would make it very difficult, if not impossible, to attain the other objectives of monetary policy.

12. Consumer prices have a tendency to rise relative to wholesale prices. This is because such prices contain a larger element of services than commodity prices. As output per unit of effort for many services rises less than output per unit of effort in commodity production, while wages, salaries and fees in both types of employment tend to move together, the long-run trend of consumer prices will be to rise relative to wholesale prices. In a period of rapid price fluctuation, consumer prices will rise or fall less than wholesale prices. In a period of relative stability in wholesale prices, consumer prices will rise steadily, say, by about 1 per cent a year. In the United States, for example, wholesale prices are about the same in 1962 as in 1958, but consumer prices have risen by 5 per cent.

13. If monetary policy were directed toward maintaining stability of consumer prices, the structure of all other prices would have to be adjusted to an appropriate relationship with this index. Wholesale prices would have to fall by an average of about 1 per cent a year. Wage rates would have to rise at an average rate of about 2 per cent instead of 3 per cent

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a year. Interest rates would have to be lower by about 1 per cent. Such a pattern of prices and interest rates would make it much more difficult to achieve the objectives of monetary policy.

14. In every dynamic economy, some changes in relative wages are necessary. It would be much easier to adjust relative wage rates in different industries, and the average level of wages relative to those in other countries, if the normal rise in wages were about 3 per cent a year instead of 2 per cent a year. If wholesale prices are kept approximately stable, the wage differential between industries can be widened by about 3 per cent a year without necessitating a reduction of wages in the declining industries. Furthermore, where wage costs have to be held down to strengthen the international competitive position of a country, it is much easier to achieve a relative gain of, say, 1 per cent a year for a few years when the average rise of wages is 3 per cent a year instead of 2 per cent a year.

15. If consumer prices were kept stable, interest rates would have to be about 1 per cent lower. To induce investment, the expected gross annual return from a project must be equal to the gross annual investment cost-- that is, depreciation and interest. As wholesale prices would be declining, the gross return would tend to be lower under a policy that undertakes to keep consumer prices stable. To offset this, interest rates would have to be lower. It is much more difficult to use monetary policy effectively when the appropriate level of interest rates is very low.

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16. In a world economy, where stability of exchange rates is accepted as one objective of monetary policy, it is necessary for the great trading countries to follow consistent price objectives. If all countries were to undertake to maintain stability of the consumer price index, this would involve different rates of decline in their wholesale prices. As these are the prices of international trade goods, the relative prices of export goods would soon depart from the relationship necessary for a strong pattern of international payments. On the other hand, if all countries were to undertake to maintain stability in the wholesale prices of industrial goods, the relative prices of export goods would generally be appropriate for balancing international payments. Any adjustment in relative export prices to take account of changes in reciprocal demand could be achieved through moderate changes in wage rates relative to productivity-- with a slightly higher rise in wages relative to productivity in surplus countries and a slightly smaller rise in wages relative to productivity in deficit countries.

17. It may be useful to give greater precision to the concept of approximate stability in the wholesale price level of domestically produced industrial goods. For the great trading countries, this is the price level of most of their exports. Some of the great trading countries are also exporters of agricultural products. This does not require any qualification in the price objective of monetary policy. Agricultural prices can be adjusted to world levels

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without the necessity of difficult adjustments in wage rates. Furthermore, as agricultural prices may follow a rising or falling trend for long periods, the stabilization of a price level including such products would necessitate an offsetting fall in industrial prices when agricultural prices rise and an offsetting rise in industrial prices when agricultural prices fall. It is inconceivable that a country could follow a price policy that might require a fall in wage rates as agricultural prices rise and a rise in wage rates as agricultural prices fall. This would not be helpful to the domestic economy and it would be completely destructive of the balance of payments.

18. Approximate stability of prices is not intended as a euphemism for a slow but steady inflation. Rather, it is a recognition of the fact that it is impossible to maintain absolute stability of wholesale prices of domestically produced industrial goods because of cyclical fluctuations in economic activity. A rise of one or two per cent in a period of expansion, largely accounted for by higher prices of industrial raw materials, and a fall of the same magnitude in a period of contraction are completely consistent with the objective of long-term stability of the wholesale price level.

19. Furthermore, some small changes in the price level may be necessary for balance of payments reasons. When a country's demand for imports is rising steadily relative to its exports, a persistent balance of payments deficit can be avoided only by strengthening the trade position or by increasing foreign exchange receipts

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relative to payments in other ways. An improvement in the trade position may require a lowering of export prices relative to those of other countries. This can be achieved by limiting the rise in wages for a time to somewhat less than the average increase in productivity in the export industries. A modest adjustment of relative prices in this way is consistent with the objective of approximate stability in the wholesale price level of domestically produced industrial goods. On the other hand, there will be occasions when a small rise in prices may be necessary. Thus, if a country has a persistent balance of payments surplus, resulting from an improvement in its real international economic position rather than from widespread inflation abroad, it would be appropriate to permit wages to rise somewhat more than productivity and thus to secure an appropriate relationship to the export prices of other countries through a rise in domestic prices.

20. In a world economy based on the principle of stable exchange rates, monetary policy must be directed toward maintaining approximate stability in the wholesale price level of domestically produced industrial goods. While this may involve a very slow rise or fall in the price level for a limited period, as a method of adjustment, it does not justify an attitude of indifference toward a persistent rise in prices not resulting from a balance of payments surplus. Under present conditions, when the danger of widespread inflation in the great industrial countries is negligible,

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a country with a persistent tendency toward higher prices, as a consequence of wages rising more rapidly than productivity, will inevitably be confronted with a persistent balance of payments problem. An appropriate wage policy is necessary for price stability. Monetary policy must, therefore, provide an environment which is conductive to keeping the average rise in wage rates closely linked to the increase in productivity in the industrial sector.

Stable exchange rates

21. The stability of exchange rates as an objective of monetary policy must be understood within the framework of the principles in the Articles of Agreement of the International Monetary Fund. The Fund requires each country to agree a parity for its currency. Thereafter, it must maintain exchange rates within one per cent of the agreed parity without imposing restrictions on current exchange transactions, except as such measures are authorized by the Fund. To help countries meet temporary balance of payments deficits, without the necessity of imposing exchange restrictions or altering the agreed parity, the Fund provides assistance from the common reserve it holds for all its members.

22. This concept of exchange stability must be distinguished from that embodied in the traditional gold standard as it was operated before the 1930's. Under the traditional gold standard, stability in the gold value of the monetary unit was considered the primary

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objective of monetary policy and all other objectives of monetary policy were subordinated to that end. The money supply was closely tied to reserves of gold or foreign exchange and therefore quickly affected by a balance of payments surplus or deficit. The traditional way of dealing with a persistent balance of payments deficit was for the monetary authorities to impose severe deflationary measures on the economy. This is not the purpose of the International Monetary Fund. If stable exchange rates can be maintained only by imposing severe restrictions on current transactions or by deflating the domestic economy, the Fund recognizes that it would be preferable to alter the agreed parity.

23. In a world economy that is functioning reasonably well, a great trading country will find that a fixed parity, appropriate to its international economic position, is a helpful means of maintaining a greater degree of stability of production, employment and prices. Suppose, for example, that a country has a boom so that the demand for resources for domestic investment increases more rapidly than the availability of domestic savings adjusted for the normal inflow or outflow of capital. If there were no way to acquire supplementary resources (imports) from abroad, the excessive home demand would cause a rise in prices; and if the pressure of excessive demand were large and persistent, it would lead to inflation. In a world economy , however, it is possible for a country to have an import surplus and in this way to acquire the

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additional resources that enable it to maintain home investment and hold down the pressure of excess demand.

24. Similarly, when a country has a recession, the world economy absorbs part of the effect of the decline in aggregate demand and minimizes the impact on production and employment. In a recession which is confined to one or a few countries, imports fall relative to exports and the increase in the trade surplus enables a country to maintain production and employment at a higher level than would otherwise be possible. A country whose cyclical fluctuations tend to coincide with those of the United States, and a great part of whose trade is with the United States, will not derive as much stabilizing effect from the world economy as a country whose cyclical fluctuations are wholly independent of those of other countries. Nevertheless, even such a country will find that its balance of payments on current account ordinarily tends to move counter to its domestic economy.

25. In a country with a fluctuating exchange rate, the behavior of the exchange rate may exaggerate the effects of its own cyclical fluctuations. When there is an increase in aggregate demand, imports rise. This will compel a decline in the foreign exchange value of its currency and import prices will rise correspondingly. The depreciation of the exchange rate might also induce a rise in the prices of some export goods. On the other hand, when there is a decrease in aggregate demand, imports fall. This will compel a rise in the foreign exchange value of the currency. The appreciation of

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the exchange rate would induce a fall in the prices of some export goods and the lower prices of import goods would put pressure on the prices of competing domestic goods. Thus a fluctuating exchange rate may intensify the usually moderate fluctuation of prices in a business cycle.

26. The stabilizing effect of the world economy depends upon the magnitude of its trade of more than $120 billion a year, from which an individual country can draw relatively more in the way of imports in time of boom and into which it can contribute relatively more in the way of exports in time of recession without seriously affecting the economy of other countries. Thus other great trading countries absorb in small part some of the instability originating in another country with a cyclical expansion or contraction, and they can do this without adverse effects on their own economy because each country's share in providing more exports or in taking more imports is so small. On the other hand, the aggregate benefit to the country with the cyclical fluctuations from the contribution to its stability made by other countries may be quite significant.

27. There are instances in which a policy of fluctuating exchange rates would be justified. In a country highly dependent on exports of one or a few basic commodities, large cyclical fluctuations in the prices of its exports could lead to severe inflation and deflation. The changes in prices of export goods would generate an excessive expansion of aggregate demand when there is a rise in prices and a severe

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contraction of aggregate demand when there is a fall in prices. Furthermore, the real income effects of a large rise or fall in prices of basic export commodities would be concentrated on the export sector. With a fluctuating exchange rate, the real income effects would be shared by all sectors of the economy, approximately in proportion to their absorption of import goods. This would not prevent serious consequences from the large fluctuations in the real income of the economy, but it would spread the incidence in some reasonable way over the economy as a whole and it would moderate the domestic fluctuations in economic activity induced by large changes in export prices.

28. A policy of fluctuating rates could also be justified if there were a tendency in the rest of the world toward persistent inflation. A country that is able to maintain price stability at home could be subjected to inflation from a persistent excess of demand abroad. The balance of payments surplus would reduce the output available to meet domestic demand and the accumulation of reserves would either expand the domestic money supply or require offsetting action by the monetary authorities. Under these circumstances, a country could attempt to minimize the domestic effects of the inflation abroad through a steady appreciation of its currency in a freely fluctuating market. The case is not significant under present conditions. The fact is that other great trading countries are not suffering from an inflation that would impose difficulties on any other country.

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29. The great difference between the system of fixed exchange rates under the International Monetary Fund and under the gold standard is that the Fund recognizes that a change in parity may be necessary and provides an orderly way for making such a change. It is not in the interest of the rest of the world for a great trading country to continue an inappropriate rate of exchange. The support of an overvalued exchange rate through restrictions on current transactions limits the exports and imports of a country, to the detriment of that country and the world economy. The attempt to restore the balance of payments through domestic deflation may be even more destructive. It imposes an inadequate level of production and employment on the domestic economy without entirely avoiding the limitation on exports and imports. For this reason, the Fund regards a change in parity as an appropriate means of correcting a large and persistent balance of payments deficit.

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II. The Role of Monetary Policy

Monetary policy and economic policy

30. In setting forth the objectives of domestic monetary policy in connection with production and employment, prices, and exchange rates, it is not intended to imply that these objectives comprehend the whole range of economic objectives or that monetary measures are the only means by which these objectives can be achieved. The fact is that monetary policy deals with only one aspect of the forces acting on the economy, and while monetary measures are of great and universal importance, they are not omnipotent.

3. It should be noted that the objectives of monetary policy are by no means the only economic objectives of Government. The broader objectives of economic policy are related to the structure of the economy, the distribution of income, the use of income for consumption and investment, etc. Although the role of monetary policy in these broader economic objectives is necessarily limited, it is not without some effect. For this reason, monetary policy must conform to the broader objectives of the economic policy of the Government. In some instances, monetary policy can be used to contribute to the attainment of other economic objectives. In other instances, monetary policy can be used to avoid undesirable repercussionary effects from measures taken by the Government to achieve other economic objectives.

32. It is commonplace to say that fiscal policy, wage policy, trade policy, etc. have a tremendous

II. The Role of Monetary Policy

50. In setting forth the objectives of domestic monetary policy in connection with production and employment, prices, and exchange rates, it is not intended to imply that these objectives comprehend the whole range of economic objectives or that monetary measures are the only means by which these objectives can be achieved. The fact is that monetary policy deals with only one aspect of the forces acting on the economy, and while monetary measures are of great and universal importance, they are not omnipotent.

51. It should be noted that the objectives of monetary policy are by no means the only economic objectives of Government. The broader objectives of economic policy are related to the structure of the economy, the distribution of income, the use of income for consumption and investment, etc. Although the role of monetary policy in these broader economic objectives is necessarily limited, it is not without some effect. For this reason, monetary policy must conform to the broader objectives of the economic policy of the Government. In some instances, monetary policy can be used to contribute to the attainment of other economic objectives. In other instances, monetary policy can be used to avoid undesirable repercussionary effects from measures taken by the Government to achieve other economic objectives.

52. It is commonplace to say that fiscal policy, wage policy, trade policy, etc. have a tremendous

impact on production and employment, the level of prices, and the balance of payments. At times, such policies may be more effective than monetary measures in achieving some or all of the objectives of monetary policy. This is not a justification for the view that monetary policy can be neglected. Even when other measures are used to attain these objectives, their effectiveness will depend in part on having monetary policy directed to the same ends. Furthermore, as monetary policy can be applied much more quickly and flexibly than some other measures, the initial steps in achieving these objectives will almost always have to be taken by way of monetary policy.

Credit policy and the money supply

33. The basic role of monetary policy arises from the fact that the Central Bank is charged with managing the monetary system of the country. Its first task is to assure a supply of money that will enable the economy to function effectively.* The production, the distribution and the use of the national product involve financial transactions for which the economy needs money. As production grows,

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* The money supply in this discussion is defined as currency outside banks plus demand deposits adjusted to exclude the deposits of the national Government and interbank deposits. This is the definition of the Board of Governors of the Federal Reserve system and it is used to facilitate consideration of the problems involved in acting on the money supply in the United States.

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the need for money grows, ordinarily at about the same rate as the increase in the national product. If the money supply increases too little, it may tend to restrain the growth of aggregate demand and cause unemployment. If the money supply increases too much, it may tend to encourage excessive aggregate demand and cause inflation.

34. Over longer periods-- and even in short periods-- the need for money may not increase at the same rate as the increase in the national product. This is particularly true as new institutional arrangements are evolved for holding liquid assets, other than money, or as the inducement to hold money relative to income earning assets changes. It is not possible, therefore, to determine directly from a comparison of the rate of growth of the money supply and of the gross national product whether the increase in the money supply has been excessive or deficient. As long-term interest rates tend to vary with the ratio of the gross national product to the money supply (the velocity of money), the conjuncture of high interest rates and persistent unemployment may indicate an inadequate growth of the money supply while low interest rates and inflation may indicate an excessive growth of the money supply.

35. As a practical matter, monetary policy acts on the money supply by constant short-run adjustment of credit conditions to the needs of the economy rather than by deliberate measure to achieve a particular money supply. Under certain conditions the monetary authorities

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75. As a practical matter, monetary policy acts on the money supply by constant short-run adjustment of credit conditions to the needs of the economy rather than by deliberate measure to achieve a particular money supply. Under certain conditions the monetary authorities

may not be able to increase the money supply by what might appear to be a reasonable amount without risking serious adverse effects. In the expansion from the first quarter of 1961 to the second quarter of 1962, the gross national product of the United States increased by $51 billion a year (about 10 per cent). In the same period, the money supply increased by $4.5 billion (about 3 per cent). Throughout this period, the Federal Reserve Banks maintained a high level of free reserves and member banks increased their assets substantially. The failure of the money supply to increase at the same rate as the gross national product is accounted for by the fact that time deposits in all commercial banks increased by about $17 billion, apart from the increase of savings deposits in other institutions. Furthermore, there was a large outflow of short-term funds from the United States. If the Federal Reserve Banks had provided the banking system with much more reserves, they would probably have induced a larger increase in time and savings deposits and a greater capital outflow without significantly increasing the money supply.

36. The key to an appropriate monetary policy is easier credit at relatively low interest rates when production and employment are low, and tighter credit and relatively high interest rates when production and employment are high. The great change in the economic environment in recent years and the persistent high level of unemployment has caused a striking change in credit policy in the United States and will probably lead

to a similar change in other countries. So long as the economy was under inflationary pressures, in fact until 1960, the Federal Reserve authorities regarded it as necessary to place the economy under restraint in a period of cyclical expansion. Throughout the 19 months of the expansion so far in this cycle, however, the Federal Reserve has provided a generous level of free reserves, that is, excess reserves less member bank borrowings. In the last few months, the free reserves of member banks have been reduced from an average of $500 million to about $350 million, primarily to keep the yield on Treasury bills above 2-3/4 per cent in order to minimize the outflow of short-term funds. This will be the first cycle since 1949 in which the member banks will not have had net indebtedness to the Federal Reserve at some time during the expansion.

Availability of credit and interest rates

37. The effect of monetary policy on economic activity depends in large part on the environment in which it is applied. When the economy is already well supplied with cash balances, it is not possible to prevent inflation, in a period of great demand for output, through the ordinary operations of monetary policy. This was the situation in the early postwar years. Nevertheless, there was a tendency to underestimate the extent to which monetary policy could restrain inflation. Similarly, in a period of deep depression it is difficult to create a great inducement to expansion through monetary policy. A very

to a similar change in other countries. So long as the country was under inflationary pressure, in fact it is necessary to place the economy under restraint in a period of cyclical expansion. Throughout the 18 months of the expansion so far in this cycle, however, the Federal Reserve has provided a generous level of free reserves, that is, excess reserves less member bank borrowings. In the last two months, the free reserves of member os ks have been reduced from an average of $500 million to about $250 million, primarily to keep the yield on Treasury bills above 2-3/4 per cent in order to maintain the unity of short-term funds. This will be the first cycle since 1949 in which the member banks will not have had net indebtedness to

Vulnerability of credit and interest rates

IV. The effect of monetary policy on economic activity depends to large part on the environment in which it is applied. When the economy is already well supplied with cash balances, it is not possible to prevent inflation. In a period of great demand pressure, through the ordinary operations of monetary policy. This was the situation in the early postwar years. Nevertheless, there was a tendency to credit accompanied the effort to widen monetary policy could restrain inflation. Similarly, in a period of deflation it is difficult to create a great increase

easy credit policy, as in the 1930's may result in flooding the economy with unused cash balances rather than in bringing about an adequate recovery in production and employment. Even under such conditions, an easy credit policy can contribute to some extent to economic recovery.

38. The most favourable environment for effective monetary policy is a period in which aggregate demand is neither too strong to be restrained nor too weak to be stimulated through credit policy. This is the environment in the United States at present and the environment that is likely to continue for some time. The shift in the credit policy of the Federal Reserve in the past two and a half years is a recognition of the fact that the environment has shifted from one of excessive aggregate demand to one of deficient aggregate demand. The bolder use of credit policy that is possible in the new economic environment is limited to some extent by the more sensitive balance of payments situation. Despite this, credit policy is now much bolder than in the past and this has been helpful to the economy.

39. There may be some question regarding the precise effect of credit policy on the level of economic activity, but there can be no doubt that it does have some positive effect. A great deal of investment is undertaken with borrowed funds. Under these circumstances, it is inevitable that some expenditure will be dependent on the availability of credit. In periods of tight credit, it will not be possible to

easy credit policy, as it the tools may result in flooding the economy with unused cash balances rather than in bringing about an adequate recovery in investment are employment. Even under such conditions, an easy credit policy can contribute to some extent to economic recovery.

26. The most favourable environment for effective monetary policy is a period in which expenditure demand is neither too strong to be restrained nor too weak to be stimulated through credit policy. This is the environment in the United States at present and the environment that is likely to continue for some time. The shift in the credit policy of the Federal Reserve in the past two and a half years is a reflection of the fact that the environment has shifted from one of excessive aggregate demand to one of deficient aggregate demand. The modern role of credit policy that is operative in the new economic environment is limited to some extent by the more selective behaviour of expenditure stimulation. Double duty, credit policy is now much busier than it has had to be relative to the economy

29. There may be some question regarding the precise effect of credit policy on the level of economic activity, but there can be no doubt that it does have some positive effect. A great deal of investment is undertaken with borrowed funds. Under these circumstances, it is inevitable that some reduction will be occasioned in the availability of credit

finance some investment, and such investment will be put off or abandoned. In periods of easy credit, there will be an inducement to undertake some investment that might not otherwise have been made at all or at that time. Thus, a flexible credit policy will tend to reduce the amplitude of cyclical fluctuations and a generally easier credit policy will tend to raise the average level of production and employment.

40. The changes in the level of interest rates that accompany changes in credit policy are an important factor in bringing about an increase or decrease in investment relative to what it would have been at different interest rates. There are some types of investment in which interest rates are of relatively great importance in determining the total cost of a project. This is true of construction, the investment of local governments, and the investment of public utility and other enterprises with large capital per unit of output. Even for ordinary business enterprises, interest rates are of some consequence in determining how much investment to undertake and when to undertake it.

41. When a business firm is considering whether to undertake investment to expand production, it will have to determine whether the gross annual investment return will amply cover the gross annual investment cost -- that is, depreciation and interest. The gross annual investment return depends upon the expected average annual output attributable to the investment, the probable price at which it can be sold,

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and the expected cost of materials and labour used in production. As all of these computations involve projections over a number of years, the gross investment return cannot be estimated with great accuracy and estimates are, as a consequence, made on a fairly conservative basis. While interest rates may not be the decisive factor in determining whether any given investment will be undertaken, there will be a greater inducement to undertake investment, under any given conditions, at lower interest rates than at higher interest rates.

42. The importance of interest rates is even greater when a business firm is considering whether to replace equipment it already has with new equipment. As this need not involve expansion of productive capacity, although the old equipment may be retained for standby use, it is less important to project the probable output and the gross investment return. The decisive question is whether the out-of-pocket costs of production with the existing equipment will be higher than the out-of-pocket costs <u>plus</u> the gross investment costs with the new equipment. Of course, a firm would not be willing to undertake new investment unless it were reasonably sure that it could sell the output. This would not require an expansion of sales unless the capacity of the new equipment is larger than that of the equipment it replaces. For these reasons, interest rates may be of greater importance in determining whether investment should be undertaken for raising productive

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efficiency than in undertaking investment for expanding capacity.

43. Changes in interest rates may act on the inducement to invest in another way. When interest rates rise to levels where they are higher than may be expected to prevail in the course of the next year or two, business firms may put off investment until credit can be secured on more favourable terms. On the other hand, when interest rates fall to levels where they are lower than may be expected to prevail in the course of the next year or two, business firms may anticipate investment that would otherwise be undertaken later. The expected changes in interest rates over time, particularly those of a cyclical character, may have little effect on the aggregate level of investment over the course of a cycle. Such changes in interest rates may, however, induce a shift in investment from periods of higher economic activity to periods of lower economic activity.

44. The significance of relative interest rates, as distinguished from their absolute level, is particularly important in connection with the balance of payments. Ordinarily, a rise in short-term interest rates in one country relative to those prevailing in other countries, will induce an inflow of short-term funds. This may take the form of a shift in the financing of trade from one country to another or it may take the form of actual transfers of liquid funds to secure the higher interest return. A rise in long-term interest rates in one country

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44. The significance of relative interest rates, as distinguished from their absolute level, is particularly important in connection with the balance of payments. Conversely, a rise in short-term rates in other countries, will induce an inflow of short-term funds. This may take the form of a shift in the financing of trade from one country to another or it may take the form of actual investments. If funds tend to secure the higher interest returns
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relative to those prevailing in other countries is less significant, although not without some effect, for long-term capital movements other than direct investment. The issue of new securities in one market rather than another depends not only on relative interest rates, but on the facilities for handling new issues. Even so, a rise in interest rates may induce a prospective foreign borrower to delay a new security issue in the expectation that the capital can be raised later at lower interest cost.

Edward M. Bernstein

Washington, D.C.
September 7, 1962

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September 7, 1965

Nethercut & Young
Toronto, Ontario

The Balance of Payments and the Level of Employment

Basic relationships

Classical economic analysis recognized the importance of the balance of payments surplus and deficit as a factor affecting the national economy. A balance of payments surplus (on current and capital account) resulted in an inflow of reserves, an easing of credit, and an expansion of aggregate demand. On the other hand, a balance of payments deficit resulted in an outflow of reserves, a tightening of credit, and a contraction in aggregate demand. Thus, the domestic economy responded to the payments surplus or deficit in a manner that tended to restore balance. While classical writers differed in the emphasis that they put on the role of price and income in the adjustment, there is no doubt that many of the economists of the early 19th century were aware of the importance of changes in aggregate demand as a major factor in the restoration of a balanced payments position.* As these economists were less concerned with cyclical fluctuations, they gave no attention to the impact of the payments surplus or deficit on the level of employment during the period of adjustment.

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* Jacob Viner, Studies in the Theory of International Trade, pp. 293-307

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international transactions in goods and services as a factor in determining the current level of output. Exports of goods and services absorb output and contribute to aggregate demand. At the same time, imports of goods and services supply output and absorb demand. It is not possible to show purchases of imported goods and services separately for each major category of domestic expenditure--consumer expenditure, Government purchases of goods and services and gross private investment. Instead, the national accounts show these categories without distinguishing whether expenditure is on domestic goods and services or imported goods and services. Exports and imports of goods and services are then shown as a factor either increasing aggregate output relative to home demand (net exports) or decreasing aggregate output relative to home demand (net imports).

These two methods of relating the balance of payments to the national economy are not in conflict. No country can continue indefinitely to have a deficit in its over-all payments without taking action to restore balance in its international accounts. A deficit country with large reserves may have greater freedom in the scope and timing of the action it takes. Ultimately, however, it will be compelled to limit its international payments, either through financial policies holding down home demand or by direct restriction. It is less clear that the acquisition of reserves will impel a country to eliminate a surplus in its payments. The monetary authorities

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now have greater freedom and better means of managing the money and credit system in accordance with the needs of the domestic economy than they had in the past. In fact, the first effect of a balance of payments surplus may be to induce the monetary authorities to restrict domestic credit in order to avoid inflationary pressures. Nevertheless, in the long run, a persistent balance of payments surplus will probably induce expansion.

The role of net exports or net imports in the national product accounts must be interpreted with caution. Net exports (or imports) show that international transactions in goods and services are a net absorber of domestic output (or demand). It cannot be concluded from this that domestic output is greater (or less) than it would otherwise be, for the pattern of the domestic economy may have been adjusted to supplying net exports (e.g., for a capital exporting country) or to absorbing net imports (for a capital importing country). Cyclical changes in the level of net exports or net imports indicate whether the economy has received an impetus for expansion or contraction from its international transactions in goods and services, but not the effect of such transactions on the average level of employment. For that, we need a more sophisticated analysis, concerned not only with the actual level of net exports or net imports, but with its suitability for the changing nature of the domestic economy and a country's position in world trade and payments.

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Net exports in the United States, for example, may be too low and net imports in Canada may be too high to enable these countries to have an adequate level of output and employment.

Capital movements and the domestic economy

In the classical theory, a steady flow of long-term capital is presumed to have no effect on the level of employment either in the capital exporting or the capital importing country. The capital inflow enables the capital importing country to balance its international accounts at a lower level of exports relative to imports than would otherwise be possible. This means that a capital importing country can have a higher level of wages and a lower level of interest rates than would be possible with a smaller capital inflow or with no capital inflow. And it means that the level of home investment can be higher relative to home savings than would otherwise be possible. In a country with flexible exchange rates, the effect of the long-term capital inflow may be to appreciate the currency rather than to raise money wages. Regardless of the exchange system, real wages would be higher and interest rates would be lower than without the capital inflow.

In the capital exporting country, the outflow of capital is also presumed to have no effect on the level of employment. The capital outflow compels a country to balance its international accounts at a

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higher level of exports relative to imports than would otherwise be necessary. This requires the capital exporting country to have a lower level of wages and a higher level of interest rates than would be necessary with a smaller capital outflow or with no capital outflow. It also requires the level of home investment to be lower relative to savings than it would otherwise be. With the capital outflow, the domestic economy is more dependent on export markets and less dependent on home markets, but with the proper level of wages and interest rates, there is presumed to be no adverse effect on employment.

It is not a matter of indifference to a country what its level of capital exports (or capital imports) may be. In the capital exporting country, the outflow of capital is at the expense of home investment and home consumption. The terms of trade are less favourable because of the capital outflow. It is conceivable that in a world of free capital movements, the capital outflow induced in a country by relative interest rates and relative profits would be excessive, given the effects on home investment and consumption and on the terms of trade. Similarly, in the capital importing country, it is conceivable that the capital inflow may have a greater effect in raising real wages than in increasing home investment. It may be open to question, therefore, whether the social cost of future servicing of the marginal investment may not be higher, when the trade pattern must be shifted, than the social yield of the marginal investment. It is

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worth noting that in the United Kingdom, during the 1920's, some critics raised the question whether capital outflow was an excessive burden to the domestic economy. And in Canada, similar questions are being asked about the capital inflow of recent years. This aspect of the optimum flow of capital is concerned with measuring the national benefits and costs of capital exports and capital imports. It is entirely separate from the question of how capital flow affects the level of employment.

Even accepting the classical assumption that the long-run level of employment is not ordinarily affected by capital flow, it would still be true that a wide range of domestic policies would have to be adjusted to bring about the wage and interest rates (and in a country with flexible exchange rates, the rate of exchange) which would enable a changing domestic economy to supply (or absorb) a changing level of foreign investment without generating unemployment. If these adjustments in domestic policies cannot be made, or cannot be made promptly, unemployment could emerge for a shorter or longer period. For example, in an economy in which domestic forces are gradually diminishing the dependence on capital inflow to finance an adequate level of home investment, it is possible that extraneous forces (say, operating in the capital exporting country) could bring about conditions that would lead to an excessive rate of unemployment, either persistently or at some stage of the business cycle.

In his Annual Report for 1960, the Governor of the Bank of Canada has made the following statement:

> "The view that Canada could not have enjoyed sufficient economic growth without this vast increase in foreign investment in Canada, and that the Canadian standard of living would have been much lower if we had not had this vast increase in foreign investment in Canada, appears to me very questionable. The nature of our development might have been somewhat different, but I believe a higher average rate of employment could have been maintained, and more growth of total employment and of production of goods and services in Canada could have been achieved with much less reliance on a net increase of foreign investment in Canada if Canadian policies had aimed at such a target in the past, and could be achieved by Canada in the future if Canadian policies are in future aimed at such a target."

These are difficult but important questions. In this paper, only one of these questions is considered specifically-- whether the level of employment in Canada in recent years would have been higher with a lower level of capital inflow. Indirectly, of course the answer to this question may provide a partial answer to the other questions regarding the effect of

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Nethercut & Young
Toronto, Ontario

the capital inflow into Canada on the rate of economic growth and on the standard of living. In any case, the following section is not concerned with matters of Canadian policy, but with an analysis of economic forces under the special conditions that prevailed in Canada in recent years.

Capital inflow in Canada

In the postwar period, Canada has had an enormous shift in its balance of payments. This is accounted for by the change in its position from being a large net supplier of resources (aid) in the early postwar years to being a large net absorber of resources (capital inflow) in recent years. Except for the period from 1950 to about 1955, Canada's balance of payments on current account was not well suited to the needs of its domestic economy. From 1946 to 1949, Canada had a large current account surplus (2.8 per cent of the GNP in 1948) because of the very considerable amount of aid it provided for European reconstruction. From 1950 to 1955, Canada had a moderate deficit on current account (averaging about 1.6 per cent of the GNP). From 1956 to 1960, however, Canada had a very large deficit on current account, ranging from 3.1 to 4.5 per cent and averaging 3.9 per cent of the GNP.

The current account surplus in the early postwar years came at a time when Canada's need for resources at home was very large and when a capital inflow would have been justified on economic grounds. It represented

the capital inflow into Canada on the rate of economic growth and on the standard of living. In any case, the following section is not concerned with matters of Canadian policy, but with an analysis of economic forces under the crucial conditions that prevailed in Canada in recent years.

Capital Inflow in Canada

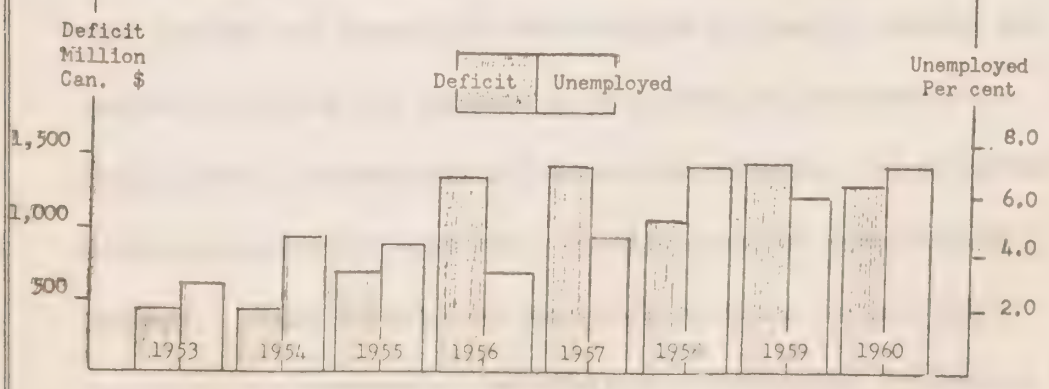
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The current account surplus in the early postwar years came at a time when Canada's need for resources at home was very large and when a capital inflow would have been justified on economic grounds. It represented

a considerable sacrifice to Canada in reduced home investment and consumption to provide European aid in this period. From 1950 to 1955, the current account deficit was of reasonable magnitude and came at an opportune time, when home investment was rising considerably and unemployment was at a tolerable level. Since 1956, however, the current account deficit has been unusually large, reaching a peak of $1,405 million in 1959. Moreover, in the three years from 1958 to 1960, this large deficit has coincided with a decline in gross private investment, in absolute terms and relative to the GNP, and with a period of serious unemployment.

In considering the appropriate level of capital inflow in a country like Canada, it is important to recognize that the need for a supplement of resources from foreign investors changes gradually over time. In the ten years from 1950 to 1960, real income per capita in Canada must have risen by

CURRENT ACCOUNT DEFICIT AND UNEMPLOYMENT IN CANADA, 1953-60



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In considering the appropriate level of capital inflow in a country like Canada, it is important to recognize that the need for a supplement of resources from foreign investors changes gradually over time. In the ten years from 1950 to 1960, real income per capita in Canada must have risen by

about 20 percent. Since 1957, net private investment has declined by nearly 10 per cent in money terms. Relative to the gross national product it was lower in 1960 than in 1950. Clearly, Canada has the capacity to provide for much more of its investment needs out of its own resources. Because of the excessive inflow of foreign capital (and the consequent deficit in the balance of payments on current account), output and employment in Canada are far below the level that would be justified by home demand. The balance of payments deficit on current account is probably one of the principal factors that has kept unemployment in Canada at a persistently high rate in recent years-- 6 to 7 per cent from 1958 to 1960. There can be no doubt that if the payments deficit on current account could be reduced, say by about 2 per cent of the GNP, employment would be increased by at least the same percentage of the labour force.

It is extremely difficult to keep the capital inflow into Canada within limits suited to the economic needs of the country. The capital inflow largely takes the form of direct foreign investment and the sale of new issues of Canadian securities abroad. While the capital inflow is partly a response to economic conditions in Canada, it is also affected to a considerable extent by economic conditions in the United States. Insofar as the capital inflow varies in response to economic conditions in Canada, it helps to stabilize the economy-- minimizing inflationary pressure in periods of expansion and minimizing

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unemployment in periods of contraction. On the other hand, when the capital inflow responds to economic conditions abroad, it may become a seriously disturbing element in the Canadian economy. Furthermore, given the magnitude of the capital inflow, the monetary authorities cannot avoid an adverse impact on the Canadian economy through ordinary measures.

When the Canadian dollar had a fixed parity, an unusually large capital inflow created an enormous excess of liquidity. If this liquidity had been allowed to be absorbed by the economy, it would have been difficult to prevent excessive expansion (and price inflation) in a period of rising economic activity. On the other hand, now that the Canadian dollar operates under a system of flexible exchange rates, a large capital inflow causes an appreciation of the dollar, induces a decline in exports and a rise in imports (relative to what they would otherwise be) and forces a balance of payments deficit equivalent to the capital inflow. In a period of declining economic activity, a large capital inflow impedes the monetary authorities in their efforts to counteract recession.

The fact is that a country like Canada does not have the means of offsetting in a satisfactory way the undesirable effects of an unwanted capital inflow of the magnitude of recent years. On the other hand, the Canadian economy cannot continue to absorb the adverse effects of a large deficit in the balance of payments on current account. This is a case where the monetary authorities will have to rely on a less than

unemployment in period of contraction. On the other hand, when the capital inflow responds to economic conditions abroad, it may become a countercyclical element in the Canadian economy. Furthermore, given the magnitude of the capital inflow, the monetary authorities cannot avoid an adverse impact on the Canadian economy through ordinary measures.

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Royal Commission on Banking and Finance

CANADIAN METAL MINING ASSOCIATION.
EXPORT CREDITS INSURANCE CORPORATION.

Hearings held at
OTTAWA

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I N D E X

ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Friday,
September 14th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

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Mr. James Douglas Gibson, O.B.E.

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Montreal, Quebec

Mr. John C. Hopkins

Dr. W.A. Mackintosh

Kingston, Ontario

Mr. H.A. Hampson

Secretary

Mr. [illegible]

Joint Secretary

Ottawa, Ontario
Friday, September 14, 1962.

--- On resuming at 9.20 A.M.

SUBMISSION OF

CANADIAN METAL MINING ASSOCIATION

APPEARANCES

A.H. Zimmerman	-	Comptroller Noranda Mines, Limited.
R. Campbell	-	Executive Vice-President Falconbridge Nickel Mines Limited
N. Edmonstone	-	Vice-President and Treasurer Steep Rock Iron Mines Limited
W.H. Durrell	-	Executive Vice-President Iron Ore Company of Canada
H.C.F. Mockridge	-	Director, The International Nickel Company of Canada, Limited.
W.S. Row	-	Chairman, Gold Committee, Canadian Metal Mining Association; President, Kerr-Addison Gold Mines Limited.
E.B. Gillanders	-	President, Canadian Metal Mining Association; Executive Vice-President, The Rio Tinto Mining Company of Canada Limited
V.C. Wansbrough	-	Vice-President and Managing Director, Canadian Metal Mining Association

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THE CHAIRMAN: We have a submission from the Canadian Metal Mining Association this morning. We are very much indebted to you gentlemen for your

--- On resuming at 9.30 A.M.

SUBMISSION OF

CANADIAN METAL MINING ASSOCIATION

A.H. Zimmerman - Commissioner

R. Campbell - Executive Vice-President

N. Edmonstone - Vice-President and Treasurer; Sheep Rock Iron Mines Limited

W.H. Durrell - Executive Vice-President Iron Ore Company of Canada

R.C.K. Mountifice - Director, The International Nickel Company of Canada,

W.S. Row - President, Gold & Dross, Corporation Metal Mining

Kerr-Addison Gold Mines Limited.

E.L. Williamson - Chairman, Canadian Metal

The Hon. The Minister

Mines, o' Ontario Limited

V.C. Wansbrough - Vice-President and Managing

THE CHAIRMAN: Mr. Row's submission for
the Canadian Metal Mining Association will be morning.

We are very much indebted to you (gentlemen

very interesting brief. We all recognize the importance of the industry that you represent, and recognize also that the industry is very fully and well represented here this morning.

I may say we have all read the brief, so generally it is not required of you to read it verbatim to us. I understand that you would perhaps prefer that we carry on now and ask questions. We often do that. On some occasions some people think it is preferable to give us a summary, but I don't in this case it will be necessary. It is a comparatively short brief, so we shall now proceed with the questions.

COMMISSIONER LEMAN: Gentlemen, your brief contains a few quite specific and clear recommendations, and I would like to talk just very briefly about some of them.

In the section of your memorandum that comments about gold there is one recommendation related to Canada carrying a higher percentage of its reserves in the form of gold rather than in dollars, and I think you make the specific recommendation that the percentage be raised to 80 per cent. Then you give us some data in the brief about what, on average, has been the percentage through recent years. On average what do you think would be the cost of this move? In talking about cost, I am really talking about the carrying cost in the form of gold rather than U.S. dollars which can earn a small return for the country. Have you made a rough estimate of what the cost would be ?

MR. ROW: I don't think we have specifically made a calculation, but the cost of carrying additional amounts in gold, I presume, would simply be the return available on the same amount in U.S. treasury bills.

COMMISSIONER LEMAN: So, if we took just as a rule of thumb that on average there might be 50 per cent in gold now, and you suggest going up to 80 per cent, that would make a difference of eight to ten million dollars a year in return: something of that order?

MR. ROW: Well, what do treasury bills carry -- 2-1/2, or 3 per cent?

COMMISSIONER LEMAN: Let us assume over the long run you may be doing well if you had 2 per cent on U.S. treasury bills. We cannot make an accurate estimate.

MR. ROW: Assuming that the Canadian reserves on an average are two billion, and that in the past an average of somewhere around 50 per cent has been carried: if that were increased to 80, that would be increased by $600 million. 2 per cent of that would be $12 million a year.

COMMISSIONER LEMAN: So, there is a cost attached to this proposition. That is what I wanted to find out.

MR. ROW: Yes.

COMMISSIONER LEMAN: The second rather definite recommendation you make about gold is the suggestion that the price of gold be increased in terms

MR. ROW: I don't think we have specifically made a calculation, but the cost of carrying additional amounts in gold, I presume, would simply be the return available on the same amount in U.S. treasury

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COMMISSIONER LEMAN: Let us assume over the long run you may be doing well if you had 2 per cent on U.S. treasury bills. We cannot make an accurate estimate.

MR. ROW: Assuming that the Canadian reserves on an average are two billion, and that in the past an average of somewhere around 50 per cent has been carried: if that were increased to 80, that would be increased by $300 million. 2 per cent of that would be $12 million a year.

COMMISSIONER LEMAN: So, there is a cost attached to this proposition. That is what I wanted to find out.

MR. ROW: Yes

COMMISSIONER LEMAN: The second matter

of our currency. You don't come out and suggest how much of an increase. Have you discussed this among your members? Are there some who have a fairly precise idea of how much of an increase they would suggest?

MR. ROW: I will express, if I may, a personal view which Ithink would be pretty generally accepted, that an increase of less than 100 per cent would probably not serve the purpose which an increase should serve: that is, in order to increase international liquidity and increase the gold backing ofcurrencies which are based on gold backing.

COMMISSIONER LEMAN: If we look at the graph you have presented to us in Appendix 2 of your brief, does not the graph itself suggest that any increase in the price now, let us say, of 20 per cent, 25 per cent, or whatever one would pick, would not afford a very permanent sort of improvement for that particular purpose, ... that is, providing liquidity to support the expanding volume of world trade? If one were to use that method of giving elbow room and leeway, it would look as though it would have to be a series of successive increases, wouldn't it? Just looking at your graph, the spread is getting worse all the time, isn't it?

MR. ROW: I don't know whether it would have to be a series of increases. I would be inclined to think that a series of increases a very few years apart would create a feeling of great instability. It would seem to me that it would be one move and then

of our currency. You don't come out and suggest how much of an increase. Have you discussed this among your members? Are there some who have a fairly precise idea of how much of an increase they would suggest?

MR. HOW: I will suppose, if I may, a personal view which I think would be pretty generally accepted, that an increase of less than 10% per cent would probably not serve the purpose which an increase should serve: that is, in order to increase international liquidity and increase the gold backing of currencies which are based on gold backing.

CHAIRMAN PATMAN: If we look at the situation you have presented to us in Appendix C of your brief, does not the Group thereof suggest that any increase in the price now, let us say, of 50 per cent, by per cent, or whatever one would plan, would not afford a very permanent sort of improvement for that particular purpose, that is, providing liquidity to support the expanded volume of world trade. If one were to use that method of fixing other room and leaving it, would look as though it would have to be a series of successive increases, wouldn't it? Just looking at your graph, the spread is getting worse all the time, isn't it?

MR. HOW: I don't know whether it would have to be a series of increases. I would be inclined to think that a series of increases a very few years apart would create a feeling of great instability. It would seem to me that it would be one move and then

stability again.

COMMISSIONER LEMAN: You would favour this approach rather than a recurring effort to resort to this particular device?

MR. ROW: Yes. You see, if an increase in the price of gold were accompanied by government policies of nations of the western hemisphere, in so far as possible, in any event, to balance budgets rather than operate on deficit financing -- in other words, try to control inflation -- your graph of yearly trade increases would probably be somewhat different. I presume that this graph is in the currencies year to year, whatever their purchasing power may be. Is that right, Mr. Wansbrough?

MR. WANSBROUGH: That is right.

MR. ROW: That graph does not represent trade in constant dollars or constant currency.

COMMISSIONER LEMAN: There must be a bit of an inflation factor in the graph, but wouldn't you think this graph on the world trade must be or should be, I would suggest, based on wholesale prices which are the prices that govern world trade rather than consumer prices; wouldn't you think so?

MR. ROW: Yes, they probably are, but those wholesale prices are also inflated.

COMMISSIONER LEMAN: Yes; somewhat less than the consumer price, though, wouldn't you think?

MR. ROW: Well, some of the currencies, of course, have suffered a much greater degree of inflation than, say, the Canadian or the U.S. dollar

COMMISSIONER LUMA: You would favour this approach rather than a resurging effort to resort to this particular device?

MR. ROM: Yes. You see, if an increase in the price of gold were accompanied by governmental policies of nations of the western hemisphere, in so far as possible, to say every, to balance budgets rather than operate on deficit financing -- in other words, by to control inflation -- there would be a trade increase would probably be somewhat different. I presume that this group is in its recommendations to year, whatever credit purchasing power may be.

MR. WANGENHEIM: That is right.

MR. ROM: That group does not represent trade in overseas dollars in overseas currency.

COMMISSIONER LUMA: You mean to say is a ~~of~~ an inflation factor in the price, but would you think this group on the world trade must or should we, I would suggest, based on wholesale prices when are the prices that people world trade rather than consumer ~~price~~; wouldn't you think so?

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than the consumer price, though, wouldn't you think? of course, have suffered a much greater degree of inflation than, say, the Canadian or the U.S. dollar

or the British pound. Some of our other currencies, particularly South American currencies, have suffered very severe inflation.

COMMISSIONER LEMAN: Well, I don't want to argue much about it. This is a problem which is being discussed now by some of the best authorities in the world -- economists -- and a great deal is being written about it. Even in this morning's paper there was a discussion about what the best cure would be for international liquidity to support trade.

May I turn briefly now to a somewhat different question, which is in the same chapter of the brief, and that is your recommendation that the government continue to encourage the mining industry, and at page 5 you refer to the fact that of the 51 gold mines now operating in Canada, 42 receive government assistance, which in recent years has averaged $10 million to $12 million a year. Could you give us an idea of those 42 out of the 51: what would they represent in the way of total employment for the 51 and total production? If you do not have it readily available, you could turn it into the Commission later.

MR. WANSBROUGH: I can give you a rough answer to that. The gold mines now in receipt of government assistance are responsible for about 53 per cent of Canada's annual gold production. 33 per cent comes from mines not in receipt of government assistance because their costs don't warrant assistance. The remaining 14 per cent is produced

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COMMISSIONER TREMAN: Well, I don't want to
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per cent of Canada's annual gold production. It
accounts for about 3% per cent of Canada's total
assistance. The remaining 14 per cent is produced

as a by-product of base metal mines. The mines in receipt of assistance -- the ones responsible for 53 per cent of the annual gold production -- would represent about the same proportion, I imagine, of total employment in the gold mines, which is in the very close neighbourhood of 16,000 men; that is the total employment. So, these would represent roughly 9,000 men.

I would just add, that they are rather closely concentrated in special communities, in some cases entirely dependent on the gold mining industry.

COMMISSIONER LEMAN: May I briefly turn now to your comments about the exchange rate. There has been a very significant move in the right direction, compared to your recommendation, in the last year and a half: what do you think of the rate as it is today?

MR. GILLANDERS: I think the rate is certainly satisfactory to industry. I suppose whether it is the right rate will only be a matter of experience.

COMMISSIONER LEMAN: It has not been there quite long enough for us to see all its effects yet, is what you are suggesting. Do you think, though, at the present level it has a chance of affording an opportunity to Canada to do more fabrication of metals mined in Canada? I am thinking of the export impact of this trend?

MR. ZIMMERMAN: Speaking from one company's point of view, metal fabrication has certainly enlarged the possible markets and stimulated the export

as a by-product of base metal mines. The mines in receipt of assistance -- the ones responsible for 3% per cent of the annual gold production -- would represent about the same proportion, I imagine, of total employment in the gold mines, which is in the very close neighbourhood of 16,000 men; that is the total employment. So, these would [illegible]

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MR. GILLANDERS: Speaking from the purely point of view, metal fabrication has certainly

sales. The fabrication has improved their position.

COMMISSIONER LEMAN: So, your answer to that would be the same, that experience will tell; but are you fairly optimistic on this score? If we assume the present exchange rate, do you think it has been significant enough to be of help to the country in this sense?

MR. ZIMMERMAN: Yes, I think so.

COMMISSIONER MACKINTOSH: May I just ask on this group of topics regarding the recommendation gold be held in the reserves: do you look at this as more of a sort of vote of confidence in gold? It makes no difference, does it, economically or financially whether we hold the gold or the United States holds the gold? There is no gold going around unsold?

MR. ROW: Well, that is correct. There is no lack of market for gold. The reason for our recommendation, as it is,is that I think we feel that the trend of circumstances being as it is that it is almost inevitable that gold is going to be revalued upwards in terms of the American dollar, and probably in terms of all the member nations of theI.M.F., and if that is the case, and that happens, it would be a poor thing for Canada to be caught with a small percentage of its reserves in gold and a large percentage of other currencies.

COMMISSIONER MACKINTOSH: Is this a friendly tip?

MR. ROW: In the paper this morning, the

United States lost another $30 million of gold in the past week. They are now down to 16.068 billion, and the erosion continues. At one time they had over 24 billion. If you go to Washington you listen to all sorts of assurances they are not going to re-value gold. Of course, they can either say that or say nothing. Ultimately, they may not have control of their own situation. International circumstances may cause them to reverse the situation, but until after the fact, that is what they have to say.

THE CHAIRMAN: I understand from the brief that it is only about half of the gold produced that goes into the monetary reserve. The rest of the gold produced goes elsewhere?

MR. ROW: It goes into jewellery, industrial uses and hoards.

THE CHAIRMAN: Have you any information as to what proportion goes into hoards?

MR. EDMONSTONE: Very little into our own.

MR. WANSBROUGH: We are speaking in terms of the Western world as a whole, and not of Canada.

THE CHAIRMAN: Yes. I think those are the figures you gave -- for the Western world?

MR. WANSBROUGH: For the Western world, yes.

COMMISSIONER MACKINTOSH: The matter of the exchange rate, where you commend the pegging of the Canadian dollar at a discount, and you have indicated

United States Navy counter $10 million at Point in the past week. They are now down to 10.6 billion, and the organization continues. At one time they had over $4 billion. If you go to Washington Van Fleet to all sorts of assurances that are not going to be value gold. Of course, such can either say that or say nothing. Ultimately, they may lose control of their own situation. Treasury[illegible] circumstances may cause them to increase the ceiling, but until then the fact, real is what they have to

[illegible]

[illegible] Is there and from how rely that that case is only money of the Gold Pool that [illegible] into the necessary reserve. The value of the gold produced goes elsewhere.

[illegible]

[illegible] Have you any information re- [illegible] work proposition [illegible] this case?

MR. [illegible]: Very little into our or-

MR. WARBURTON: We are [illegible] in terms of the Western media as a whole, and not [illegible]

THE CHAIRMAN: Yes. I think those are the figures you have - for the Western world.

MR. WARBURTON: For the Western world,

COMMISSIONER WAGNERSON: The measure of the exchange rate, where you compared the peg[illegible] of the Austrian dollar as a discount, and now have [illegible]

you are in favour of the discount, have you any views on the pegging; that is to say, a fixed rate as against a floating rate?

MR. EDMONSTONE: If I may say so, I think that the pegging does give a situation where you do have some stability, where you can make some plans with some knowledge of what is going to happen; and present day international markets, without pegging -- it could be a very volatile situation.

THE CHAIRMAN: To follow up my question, are you able at the moment to indicate the proportion that might go into hoarding throughout the Western world?

MR. WANSBROUGH: Are we back on to gold?

THE CHAIRMAN: Yes.

MR. WANSBOROUGH: I haven't any figures other than those given in the brief itself, which appear to be about 50 per cent of current production.

THE CHAIRMAN: Well, that is 50 per cent that does not go into monetary reserves.

MR. WANSBROUGH: Yes.

THE CHAIRMAN: But of that 50 per cent a great deal of it is made use of for necessary purposes of one kind or another -- industrial and jewellery, and so on -- but it was mentioned that a considerable amount is hoarded by somebody -- by individuals, I suppose, and people who get their hands on it.

MR. WANSBROUGH: I would have to check the figures.

THE CHAIRMAN: It may be difficult to get those figures.

MR. WANSBROUGH: I may be wrong, but it seems to me of the 50 odd per cent that does not go into monetary uses, it breaks down at about half hoarding and half industrial and artistic uses; but that is subject to check.

MR. ZIMMERMAN: I have some figures here that I had from our gold sales department: last year, 1961, industrial consumption we estimate at having been 70,000 ounces in Canada, which is in the order of $4 million; and that private hoarding, if you like, or private sales amounted to about 300,000 ounces in Canada.

THE CHAIRMAN: And that would be how much?

MR. ZIMMERMAN: $12 million; that is, sales for safekeeping.

THE CHAIRMAN: And the amount that went into jewellery and other purposes?

MR. ZIMMERMAN: Something in excess of $4 million. It is really very small considering the total production is nearly $157 million Canadian.

THE CHAIRMAN: Well, what I had in mind was, if that is the proportion of hoarding in Canada, I don't know whether that gives any indication of what the total hoarding would be throughout the world where gold is used. I don't know whether any steps might be taken to bring that hoarding into the monetary supply or not. There is gold moving about the world and is being hoarded by individuals to a very large

those figures.

MR. HAMMOND: I may be wrong, but it seems to me of the 90 odd per cent that does not go into monetary uses, it counts down as those half bearing and bed? Incurred and artistic uses; but that is subject to check.

MR. ZIMMERMAN: I have none figures, but than I had from our gold sales department: Last year, 1961, industrial consumption we estimate at having been 70,000 ounces in Canada, which is in the order of $2 million; and that private hoarding, if you like, or private sales amounted to about 160,000 ounces in Canada.

MR. CHAIRMAN: And that would be how much

dollars for safekeeping

MR. ZIMMERMAN: Are the amount that went into jewellery and other purposes by

MR. ZIMMERMAN: Amounting to orders of $2 million. It is really very small considering the total production is nearly $147 million Canadian.

THE CHAIRMAN: Well, what I had in mind was, if that is the proportion of hoarding in Canada, I don't know whether that gives any indication of what the total hoarding, would be throughout the world where gold is used. I don't know whether any steps might be taken to bring that hoarding into the monetary supply or not. There is gold moving about the world and is being hoarded by individuals to a very large

extent: perhaps some steps should be considered to increase the monetary gold supply by preventing further hoarding.

MR. MOCKRIDGE: Perhaps a rise in the price would help.

MR. ROW: That is exactly the thing that will bring it out.

MR. WANSBROUGH: I don't think very much hoarding will take place on the North American continent as long as the United States government does not permit its citizens to own gold either at home or abroad. In other countries, such as France and the Far East, the private acquisition of gold has long been a solid fact.

THE CHAIRMAN: There must be an enormous hoarding of gold if these proportions have applied for any length of time.

MR. ROW: South America is a big market for gold. The measures which will bring that gold into monetary circuits again are the measures we suggest -- an increase in price.

MR. EDMONSTONE: I think the appetite for hoarding is in direct proportion to the citizens' idea of the stability of their own government.

COMMISSIONER BROWN: Perhaps the answer is to get more stable governments.

I would like to ask one question: in paragraph 10 you say: "It is our belief that an increase in the gold price would render international trade freer, more flexible and larger in volume." We have had

MR. MCCARTHY: Perhaps a rider in the Prime Minister's

MR. MCKEE: That is exactly the thing that will bring it out.

MR. WINKLER, Q.C.: I don't think very much

[illegible] as long as the United States Government does not permit its citizens to own gold - other than [illegible] or abroad. In other countries, such as France and the Far East, the purchase or [illegible] have been a built-in [illegible].

THE CHAIRMAN: There must be an enormous [illegible] of gold - those provisions have applied for any length of time.

MR. MCKEE: Each American has only another [illegible] two gold. The measures which will bring [illegible] two monetary channels again are two measures we suggest -- an increase in price.

MR. DUMOULIN: I think the objective for [illegible] is in order to [illegible] to the citizens' idea of the stability of their own [illegible].

CHAIRMAN PROVAN: Perhaps we could [illegible] to get more static [illegible].

I would like to ask one question. In particular to you: "It is our belief that an increase in [illegible] more flexible and larger in volume." Do you [illegible]

some quite eminent international bankers with us the last couple of days, and at least one of them has said in his opinion there is too much international liquidity at the moment; there is plenty of liquidity for handling world trade. Would you care to comment on that, because this is apparently in contrast to your belief on this.

MR. GILLANDERS: We are not, essentially, economists and it would probably be a little presumptuous on our part to differ with some banking authorities, except to say there seems to be a very wide variation of opinion amongst the bankers. So, probably the main point here would be the finality of settlement. Wouldn't this come back to the American loss of gold reserves? This, surely, must indicate a great many Europeans who are drawing on this reserve are certainly much happier with gold than with American dollars.

COMMISSIONER BROWN: But isn't it a question that gold is needed to balance international trade? It has nothing to do with the total volume of trade. It is necessary to balance the differences.

MR. ROW: That would be correct, but the differences are always going to be more or less the same percentage of the total volume. So, as the total volume increases, so do those differences increase, and hence the call on the medium for settling those differences must increase in order to meet those settlements. Would that be a correct assumption?

COMMISSIONER BROWN: That is if all the settlements are made in gold, but as they are using other means of meeting international settlements through the International Monetary Fund this provides a greater velocity, so to speak.

MR. ROW: My understanding is that that is the system which the United States is trying to have worked out with the member nations of the International Monetary Fund in the western world. I think it remains to be seen whether it is in practice actually going to work out satisfactorily. The two basic currencies, as I understand it, used for making international settlements today are U.S. dollars and gold, and the smaller the inadequate supply of gold the greater the additional strain on the supply of U.S. dollars. We understand from Mr. Roosa, and from various things one reads, that they are now getting around by agreements between the United States and nations friendly to that country to try to diversify their holdings of reserves in funds other than U.S. dollars; in other words, even the supply of U.S. dollars is somewhat inadequate.

THE CHAIRMAN: Is not your position that gold is the substance which is generally acceptable as a medium of exchange throughout the world and has been from almost time immemorial and the likelihood is it always will be, whereas the United States dollars, or any other paper currency, may or may not be in the future equally acceptable at various times?

MR. ROW: I think that is entirely correct.

THE CHAIRMAN: So that it would be prudent to increase from time to time the monetary gold supply, that that would be a measure to maintain confidence in the whole mechanism of international finance. Is that about your position?

MR. ROW: That is correct.

THE CHAIRMAN: And, incidentally, that Canada, being a gold supplier, has an interest in this whole proposition.

MR. ROW: That is correct, sir.

COMMISSIONER GIBSON: Mr. Chairman, if there are no more questions on this particular subject could I go on to ask a few questions about financing?

THE CHAIRMAN: Yes.

COMMISSIONER GIBSON: I would like to ask you a few questions about the financing of the Canadian mining industry and get your opinion as to how it might be improved. One of the points you raise in the brief is that you are in favour of a higher degree of Canadian owne rship of Canadian mining. You indicate that increased tax relief on dividends and lower personal income tax would be helpful in achieving this objective. Of course, so far as personal income tax is concerned, this is a subject which interests a great many people and can only be considered in a very much wider context. I think any industry would say that a lower personal income tax would be helpful to increase Canadian ownership. What about the tax relief on dividends? Are you talking about mining dividends only or dividends in general, or what?

making dividends only on dividends in general, or many

MR. WANSBROUGH: Our specific reference in the brief, Commissioner Gibson, is to dividends of mining companies.

COMMISSIONER GIBSON: Would you argue a special case for giving additional relief to mining companies as opposed to other kinds of companies in order to encourage more Canadian ownership, and is there any special reason why it applies to mining?

MR. WANSBROUGH: Perhaps somebody else might want to answer that question.

MR. MOCKRIDGE: I think that is recognizing the fact that the mining industry is one of the major Canadian exporters.

COMMISSIONER GIBSON: So is the pulp and paper industry, for example.

MR. MOCKRIDGE: To a lesser degree, yes, but I think that is the basis of our feeling, that perhaps some further special assistance might be given in respect of the mining industry.

MR. WANSBROUGH: I think we should make it clear that we are not suggesting we and we alone have it. It is far from that.

MR. GILLANDERS: But I think it would be better to have it by way of an incentive rather than something that is punitive against foreign funds.

COMMISSIONER GIBSON: Yes, you make that point quite clear. I would like to go on to the tax refund on dividends. The fact of the matter is that the Canadian tax relief on dividends compared to other countries is reasonable and generous. Why

in the "mile", Councilmember Mitchell, as to discussion of
missing components.

COUNCILMEMBER GIBSON: Would you create a
special case for giving additional relief to multi-
companies as opposed to other types of companies
in order to encourage those facilities, and is
there any reason why ... policies to reduce
might want to create that provision.

MR. HOFFMAN: I think that is reasonable
the idea that the zoning ordinance is one of the major
disincentives.

COUNCILMEMBER GIBSON: So we are only
doing industry, for example.

MR. HOFFMAN: To a lesser degree, yes,
but I think that to the [illegible] that
creates some "other [illegible] might be
given in exchange for the [illegible].

[illegible] I think it should be
there that we [illegible] and we allow them to
do [illegible] that case.

MR. [illegible]: That's [illegible] be
because it [illegible] of an [illegible] that
somebody else is putting [illegible].

COUNCILMEMBER GIBSON: Very good. Any
point you'd like [illegible]. I would like to go to the
[illegible] at [illegible]. This [illegible] to
[illegible] the [illegible] as [illegible] and
to other [illegible] [illegible] and [illegible].

has this not encouraged more Canadian ownership in the past ten years, let us say? Would you comment on this? I mean, one wonders about the effectiveness of this kind of arrangement in the face of the record of the past decade.

MR. DURRELL: I believe we have largely ceased to be gamblers.

COMMISSIONER GIBSON: I am sorry, sir, largely ceased to be what?

MR. DURRELL: To be gamblers. When you go into a mining venture you face, in some cases, a very definite element of risk, and Canadians as a whole in the past, the majority, have preferred to put their money in banks and savings accounts rather than in their resource developments. Speaking for the company with which I am personally associated, when we endeavoured to get money in Canada -- and I have some figures before me here -- we had to borrow $140 million. This was back in 1949-50, and we could only get $2 million in Canada.

COMMISSIONER GIBSON: And you made a really intensive effort, did you?

MR. DURRELL: We certainly did, and one of our very largest insurance companies turned us down cold. It did not want to take a chance on a mining venture. That, I think, illustrates a lack of confidence in our people and in our natural resources. I do not believe it is as acute now as it was then, but as a whole, as Canadians, we just lack, say, the gambling instinct that our friends to the south have,

and we find it very difficult to finance in Canada. You can finance small developments but on a major scale where you have to borrow hundreds of millions of dollars, the capital is not available in the first place and even with respect to smaller developments we Canadians are reluctant to put up our own money to take a chance.

COMMISSIONER GIBSON: Let us get this clearly on the record, for I take it you are talking in part about borrowing large sums of fixed interest capital?

MR. DURRELL: That is right.

COMMISSIONER GIBSON: This is one question and a very important one, but the relevancy of the dividend tax credit is to the raising of equity capital. Would you care to talk about the two matters separately, for I think they are two separate matters.

MR. DURRELL: Yes, they are. There is no doubt about that.

COMMISSIONER MACKINTOSH: I would like to interject that if you are going to encourage Canadians to be speculative and take risks, surely you ought to offer them a share in the equity.

MR. DURRELL: Well, mining companies do. Twenty-five per cent of the companies to which I am referring are Canadian-owned whereby by purchasing shares in those companies people would participate in the equity to that extent.

COMMISSIONER GIBSON: So the equity and the fixed capital went together in that case.

MR. DURRELL: At that time we had in equity some $40 million.

and we find it very difficult to finance in Geneva. You can finance small developments but on a major scale where you have to borrow hundreds of millions of dollars the capital is not available in the first place and even when respect to smaller developments we Canadians are reluctant to put up our own money to take a chance,

COMMISSIONER GIBSON: Let us get this clearly on the record. For I take it you are talking in part about borrowing large sums of money at interest (inaudible)

MR. DOERKEL: That is right.

COMMISSIONER GIBSON: This is one question and a very important one, but the relevancy of the dividend tax credit is to the raising of equity capital. Would you care to talk about the two mechanisms separately, for I think they are two separate matters.

MR. DOERKEL: Yes, they are. There is no [illegible]

COMMISSIONER MACDONALD: I would like to interject that if you are going to encourage Canadians to be speculative and take risks, surely you ought to offer them a chance in the equity.

MR. DOERKEL: Well, during construction we, twenty-five per cent of the companies to which I am referring are Canadian-owned mostly by individuals in these companies people would participate in the equity to that extent.

COMMISSIONER GIBSON: So the equity and the fixed capital went together it does not?

MR. DOERKEL: At that, one has to put up equity some 400 million.

COMMISSIONER GIBSON: Would there be so many shares that would go with each bond?

MR. DURRELL: No, not with the bonds. I am referring to the senior financing. I am talking about the shares taken up by the participants in the venture, and there were $40 million of capital stock issued, which was equity.

COMMISSIONER GIBSON: Did you distribute the equity in relation to the amount of bonds that the various groups picked up? Was there a relationship there?

MR. DURRELL: No, the bond issue was strictly a bond issue. It had nothing to do with equity.

COMMISSIONER BROWN: I believe this confusion arises because you discussed the bond issue and gambling in the same context.

MR. DURRELL: Well, I believe you have to because Canadians would not take up the bonds.

MR. EDMONSTONE: They would not even gamble in bonds.

MR. DURRELL: No. That is the reference I was making. They were not interested in taking up the bonds because they felt it was too much of a gamble.

THE CHAIRMAN: Yes, but the control lies in the equity so that if the equity is Canadian or largely Canadian, does it really matter so much from the point of view of your proposition that the bond money comes from elsewhere?

MR. DURRELL: I think it does. I think it is wrong to go out of the country to borrow money if

it is available at home. Canadians should participate to the extent that they can to help natural resources developments.

COMMISSIONER GIBSON: You are not recommending any particular action to encourage Canadians to buy bonds in mining enterprises, are you?

MR. DURRELL: No.

COMMISSIONER GIBSON: I can understand your disappointment in not selling more bonds in Canada, but are you recommending that something be done about this?

MR. DURRELL: No, I do not believe you can do anything about it.

COMMISSIONER GIBSON: You are stating it as a fact.

MR. DURRELL: Yes.

COMMISSIONER GIBSON: What about the attitude of Canadians towards mining stocks? You talk about first-class companies and highly speculative ventures, and so on. Would you say a word about that?

MR. DURRELL: We are still a bit reluctant, even in the case of smaller developments. There are other gentlemen here who have had more experience than I have in this field, but even with respect to smaller issues it is easier to sell them in the United States than in Canada, if the venture is sound.

THE CHAIRMAN: If it is unsound it is easier to sell them in Canada?

MR. DURRELL: No, in the United States, sir. To begin with you should not have an unsound development,

is available at home. Canadians should participate
to the extent that they can to help natural resource
development.

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[illegible]

COMMISSIONER GIBSON: I can understand your
disappointment in not selling more bonds in Ontario,
but are you recommending that something be done about
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COMMISSIONER GIBSON: What about the attitude
of Canadians towards putting capital -- Your bank about
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even in the case of smaller developments. There are
older gentlemen here who have had more experience than
I have in this field, but even with respect to smaller
issues it is easier to sell them in the United States
than it formerly, if the market is sound.

MR. OSBORNE: If it is proposed it is sensible
to sell soon in Canada.

MR. DURRELL: No, in the United States, sir.
To begin with you should not have an inbound development

but in respect to resources development in Canada it is easier to sell stock in the United States than it is here.

COMMISSIONER GIBSON: What I am trying to get at is this. Is there anything really strong to suggest that a further concession of dividends with regard to taxation would really add substantially to Canadian ownership?

MR. DURRELL: I think it might, having in mind that minerals are a wasting asset; that is, as you are mining it is a wasting asset. It is not like the pulpwood industry where new trees are grown, and it is not like the hydro industry where you have water running down a river. When a mine is developed and your ore is gone, that is the end.

COMMISSIONER GIBSON: What I understand is this. We made these concessions early in the post-war period, and it is a 20 per cent credit against income tax. As far as one can determine, there has been an increasing trend towards American ownership. This does not say that these concessions have not worked. The situation might have been worse if we had not had these concessions.

MR. DURRELL: I believe it would have been.

MR. ZIMMERMAN: This American ownership trend you speak of is perhaps more applicable to corporations where these provisions do not apply, and as far as individual shareholdings are concerned I would say that the greater the tax credit the more you are going to get your repatriated Canadian shares with

but a problem in resources development in Uganda is greater to well start in the United States than it is

COMMISSIONER GIBSON: What I am trying to get at is this. Is there any thing really wrong to suggest that a further conservation of distance with regard to taxation would really add substantially to [illegible] operation?

MR. DOERNER: I think it would, having in mind once obtaining one a weekly permit, that no [illegible] is a monthly permit. It is not like the railroad industry where you have one ticket good for a year, that is the end.

COMMISSIONER GIBSON: What I understand is this. Is there some evidence showing in the [illegible] period, or it is a 30 per cent overall [illegible] increase [illegible] as far as the new determination [illegible] seem as [illegible] would indicate [illegible] This does not say that these commodities have not shrunken. The effect, or might have been worse if we had not had these increases.

MR. DOERNER: I believe it would have been.

COMMISSIONER: This question on this [illegible] was asked of the railroads to [illegible] as far as individual commodities [illegible] see going to get your [illegible] [illegible]

new companies. The element of risk is such that I would imagine any income tax arrangement is not necessarily going to sweeten it sufficiently to take it out of the gambling class.

COMMISSIONER GIBSON: Unless there are some large interests behind it.

MR. ZIMMERMAN: Which really gets us into the facts as they are, that most substantial new enterprises in the mining business now, you will generally find, are backed by one of the major companies, one or more of the major companies, whose resources make it possible to really raise any kind of financing.

COMMISSIONER GIBSON: I take it that you look forward to a pretty substantial period of growth ahead, do you, in the next decade in the metal mining business?

MR. WANSBROUGH: Yes.

COMMISSIONER GIBSON: With the Canadian dollar at 92½ cents the outlook must be a bit better.

MR. EDMONSTONE: It is certainly better than when it was at a premium of 5 per cent.

COMMISSIONER GIBSON: Do you look forward to the same kind of growth you had in the last decade?

MR. EDMONSTONE: No.

MR. WANSBROUGH: I would suggest, Mr. Commissioner, that one has to begin to break the industry down into its major segments and consider them in that way. Mr. Durrell, for example, could tell you about his recent trip to Europe on an iron ore mission and what they think the prospects for the iron ore

new companies. The element of risk is such that I would imagine any income tax arrangement is not necessarily going to answer it sufficiently to take it out of the

CHAIRMAN GUNSON: Are you then for some large insurance behind it.

MR. ZIMMERMAN: Which usually gets us into the facts as they are, that most substantial new enterprises in the mining business are, you will generally find, are backed by one of the major companies, one or more of the major companies, which encourages make it pleasure to closely review our trend in financing.

COMMISSIONER GUNSON: I take it that you look forward to a pretty substantial period of growth ahead, do you, in the next decade in the metal mining business?

MR. [illegible]

COMMISSIONER GUNSON: Who will subscribe dollars a [illegible] assure the outcome be a fact before

MR. [illegible]: It is seriously before this when it was at a premium of 3 per cent

COMMISSIONER GUNSON: Do you look to what to the same kind of growth you see in the last decade

MR. [illegible]

MR. WARMINGTON: I would suggest, Mr. Commissioner, that our use to begin to [illegible] the Treasury down into its major segments and consider them in that way. Mr. Bumsted, for example, could tell us about his recent [illegible] on the iron ore mission and what they think the prospects for the iron ore

industry is likely to be in this country for the next five or six years. You have to break the industry down into its different segments. Would you care to hear from Mr. Durrell on the iron ore segment, which is an important one?

COMMISSIONER GIBSON: It might be very interesting. What I am endeavouring to ascertain is what kind of financial problems you have ahead of you. Have you heavy requirements for capital in years to come? Are they increasing or what?

MR. DURRELL: There is a tremendous amount of iron ore in Ontario that is certainly waiting for markets, and it is certainly extremely doubtful whether it will ever by financed with Canadian capital.

COMMISSIONER GIBSON: Why is that, Mr. Durrell? Are the individual amounts too big?

MR. EDMONSTONE: The amounts are too large and the financing usually comes from the same concern as the markets.

COMMISSIONER GIBSON: What does the Canadian segment of the Canadian metal mining industry feel about external control? Are they concerned about the degree in which it has increased? Do you have any particular views you would like to express on this matter?

MR. GILLANDERS: I would think on general principle most people feel that it would be good for Canada if Canadian ownership could be increased. I find that foreign capital has been necessary for the expansion of the Canadian mining industry, and I would

industry is likely to be in this country for the next five or six years. You have to break the inventory down into its different components. Would you care to hear from Mr. Burrell on the iron ore segment, which is an important one?

CHAIRMAN DAVIS: It might be very interesting. What I am endeavoring to ascertain is what kind of financial problems you have ahead of you. Have you heavy requirements for capital in years to come? Are they increasing or what?

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CHAIRMAN DAVIS: What does the Canadian segment of the Canadian metal mining industry feel about external control? Are they concerned about the degree in which it has increased? Do you have any particular views you would like to express on this matter?

MR. DILLABOUGH: I would think on general principle most people feel that it would be good for Canada if Canadian control could be increased. I find that foreign capital has been necessary for the expansion of the Canadian mining industry, and I would

think that most people would not want to see measures taken that would discourage that.

COMMISSIONER GIBSON: Yes, you have made that clear, that you do not want any restrictive measures but, on the other hand, how do the Canadian-controlled mining companies look at this? Is it something that concerns them at all?

MR. ROW: Well, speaking as a representative of the Noranda organization, within our own organization we are very glad and take a good deal of corporate pride in the fact that around 80 per cent of our shares are owned in Canada and we think that it is the best thing for Canada and for the country to have the equities of a good company owned here. I will express a personal opinion that if there is to be any choice by Canadians that they should retain control of their own equities and, if necessary, let the bonds be sold outside the country.

COMMISSIONER GIBSON: That is the next question I was going to ask you. Can we raise substantial amounts of foreign funds that are needed through fixed interest financing rather than the sale of equities abroad?

MR. EDMONSTONE: I think more can be done in that regard.

MR. MOCKRIDGE: Is it not a fact that in order to obtain bond financing you must have strong enough credits behind the enterprise to induce the lenders to put up that money, and when you get into these large operations such as Mr. Durrell has mentioned,

think that most people would not want to see measures

COMMISSIONER GIBSON: Yes, you have made that clear, that you do not want any restrictive measures, on the other hand, how do the Canadian-controlled mining companies look at this? Is it something most concerns them at all?

MR. ROY: Well, speaking as a representative of the Noranda organization, within our own organization we are very glad and take a good deal of corporate credit in the fact that around 50 per cent of our shares are owned in Canada and we think that it is the best thing for canada and for the country to have the ownership of a good company owned here. I will express a personal opinion that if there is to be any choice by Canadian that they should retain control of their own equity and, if necessary, tax for funds be paid outside its

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MR. MACDONALD: I think more can be done in that regard.

MR. MACKLIN: Is it not a fact that in order to obtain bond financing you must have already enough credits behind the corporate to insure one is to put up that money, and when you put this those large corporations such as Mr. Bassett has mentioned,

there are not sufficient of that kind of credits in Canada to give the virtual guarantees that your first mortgage lenders are going to require before they buy the bonds.

COMMISSIONER GIBSON: That is a large, diversified Canadian mining concern, and these, presumably can borrow money from the United States.

MR. MOCKRIDGE: I think the larger Canadian mining companies have been able to finance and develop new projects out of internal funds. And the larger companies -- I think, Mr. Campbell's company, for example -- have been able to sell long-term bonds, when they found it necessary to finance. But, in general, there just does not seem to be that kind of money ready to put itself on the line as a guarantee of the long-term bonds.

COMMISSIONER GIBSON: How about Canadian financing now? One of you gentlemen mentioned that you could not sell bonds to insurance companies. This was quite a while ago. How are the facilities for long-term fixed interest financing in Canada?

MR. MOCKRIDGE: I can give one illustration, and that is the financing of this Wabash Iron. There, the first mortgage bond financing was $130 million, and $10 million of that was taken by Canadian insurance companies, and the rest by American. I do not think you could get a group of Canadian insurance companies that would be willing to put $130 million into one project.

COMMISSIONER GIBSON: Is $10 million out of $130 million a pretty low proportion?

MR. MOCKRIDGE: I do not know whether I quite follow you.

COMMISSIONER GIBSON: That is a large,

can borrow money from the United States.

MR. MOONLIGHT: I think the larger mining companies have been able to finance and develop new projects out of internal funds. And the larger companies -- I think, Mr. Campbell's company, for example -- have been able to sell long-term bonds, when they found it necessary to finance. But, in general, there just does not seem to be that kind of money ready to put itself on the line as a guarantee of the long-term bonds.

COMMISSIONER GIBSON: How about overseas financing now? One of your gentlemen mentioned that you could not sell bonds to insurance companies. That was quite a while ago. How are the facilities for long-term fixed interest financing in Canada?

MR. MOONLIGHT: I can give one illustration, and that is the financing of Cassiar Iron. There, the first mortgage bond financing was $150 million, and $10 million of that was taken by Canadian insurance companies, and the rest by Americans. I do not think you could get a group of Canadian insurance companies that would be willing to put $150 million into one project.

COMMISSIONER GIBSON: Is $10 million out of $150 million a pretty low proportion?

MR. MOONLIGHT: I do not know whether I

quite follow you.

COMMISSIONER GIBSON: You regard $10 million out of $130 million as pretty unsatisfactory?

MR. MOCKRIDGE: It is fairly low. I am not saying it is necessarily unsatisfactory. It is the fact of life, apparently.

COMMISSIONER GIBSON: Do you think it is typical?

MR. DURRELL: It is a big improvement over 10 years ago.

MR. MOCKRIDGE: He could raise on a large project only $2 million.

COMMISSIONER GIBSON: This is 1949.

MR. DURRELL: Yes.

COMMISSIONER GIBSON: Has there been an improvement?

MR. DURRELL: Yes, there has been, because we have proved it could be done and make money and pay off our bonds. But at that time the president of a large steel company made a statement to the press to the effect that he thought he could not get the ore out of the country, and that wrote it off. I have no doubt that had an effect on our financing here. Now we have shown it can be done, and was done, there has been an improvement.

Mr. Mockridge says this firm was able to sell $10 million of $130 million. This is still a small percentage, but it is a vast improvement over the situation ten years ago.

MR. EDMONSTONE: I do not think Canadians have any real right to complain about the dominance of

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MR. BUSHFIELD: I do not think Canadians have any real right to complain about the dominance of

foreign control when, as individuals or institutions, they will not facilitate the financing more than they do.

COMMISSIONER MACKINTOSH: How long has there been this long-term financing?

MR. CAMPBELL: In comparatively recent times, when the companies have increased in statune.

MR. EDMONSTONE: When we did our original financing the government would not let us do it in Canada. That was during the war, of course.

MR. ROW: The whole Canadian position has changed with regard to mine financing. A corporation would be foolish to undertake financing by equity money today, because you get a return in taxable dividends, and, with the rates of taxation existing in Canada today, it would take you forever to get your capital back.

That means the Canadian taxation pattern has forced mining companies to finance by bonds or loan money rather than equity money.

MR. EDMONSTONE: Canadian taxation has also made it more favourable for foreign investment than Canadian investment.

COMMISSIONER GIBSON: In equities?

MR. EDMONSTONE: Yes.

COMMISSIONER GIBSON: You are talking about equities and not bonds?

MR. EDMONSTONE: Yes, I think this particularly applies in the oil industry.

MR. ZIMMERMAN: Yes.

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QUESTIONER MACKINTOSH: How long has there been this long-term financing?

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MR. SHOEMAKER: When we did our original financing the government would not let us do it in Canada. That was another one way, of course.

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QUESTIONER CLARK: In regulatory

MR. SHOEMAKER: Yes.

CHAIRPERSON CLERK: You are talking about equities and not bonds.

MR. ROBINSON: Yes, I think this generally applies to the oil industry.

MR. CHAIRMAN: Yes

COMMISSIONER LEMAN: When we are talking about metals like iron ore is there another problem related to this, the awareness of certain people of what the market is for iron ore, is not that better known in the States than it is in Canada?

MR. EDMONSTONE: I think that is a factor.

COMMISSIONER LEMAN: Does not that have something to do with this, the fact they are more familiar with the real market and its steadiness and the forward demand for iron ore?

MR. DURRELL: That is a factor, but we would not have been able to finance even in the United States had we not had consuming partners.

THE CHAIRMAN: "Consuming" -- what?

MR. DURRELL: "Consuming partners". That is the key of the iron ore business today, that without consuming partners, partners who will take part of your production and who own part of the equity, you cannot finance, and your production is usually in proportion to their equity. I know, in our case, our production has been 85 million tons in the last few years, but without consuming partners we would not have been able to sell a third of that. The result of financing is tied in with the partners who will guarantee to take a proportion of your production which is enough to amortize the bonds and also the debentures.

COMMISSIONER BROWN: I would like to go back to this equity financing for a moment. There is the 3-year tax exemption, the 20 per cent depletion and the 20 per cent tax creditall in favour of the equity.

COMMISSIONER LEWIS: When we are talking about metals like iron ore is there another problem related to this, the sameness of certain people of what the market is for iron ore, is not that better known in the States now? Is it in Germany?

DR. ZIMMERMANN: I think that is a fair

COMMISSIONER LEWIS: Does not that have something to do with this, the fact they are more familiar with the real market and its possibilities and the forward demand for iron ore?

MR. ZIMMERMANN: That is a factor, but we would not have been able to finance even in the United States had we not had certain [illegible]

[illegible] "Consulting" - theory

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COMMISSIONER BROWN: I would like to go [illegible] to this society [illegible] for a moment. There is the 1-year tax exemption, the 20 per cent depletion [illegible] the 20 per cent tax [illegible] in favour of the equi

Canadians, apparently, are not buying this equity. Is it because of the method by which the financing is being done? Is there a selling job that is not being done somewhere?

MR. EDMONSTONE: I think there is too much Scottish ancestry in Canadian blood, and they want more than the others.

COMMISSIONER BROWN: It is all very well talking about problems, but we are trying to solve the problems, and we can only do that if we have suggested solutions. You are more familiar with it than we are. Have you any positive suggestions to make?

MR. EDMONSTONE: It is obvious that the tax credits or inducements that have been put forward are not doing the job we want them to.

THE CHAIRMAN: Well, is it because of that?

MR. EDMONSTONE: I do not know. Something is preventing it, and maybe the inducements are not great enough.

THE CHAIRMAN: People will buy a lot of fly-by-night stocks of one kind or another because someone has gone out and sold them.

MR. EDMONSTONE: They are looking for a non-taxable profit there.

MR. ROW: May I express a personal view? I gathered, a little while back, from Mr. Gibson's question that the result of the allowance against dividends has produced disappointing results, in that Canadian ownership of Canadian equities has not

Canadians, apparently, are not buying this equity. Is it because of the method by which the financing is being done? Is there a selling job that is not being done somewhere?

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MR. EDWARDSON: They are looking for a non-taxable profit there.

MR. ROY: May I express a personal view? I returned, a little while back, from Mr. Gibson's [illegible] of the influences surrounding [illegible] has produced disappointing results. [illegible] an ownership of Canadian equities has not

increased more.

COMMISSIONER GIBSON: That is a conclusion you might draw, but I do not know who is disappointed.

MR. ROW: I forget in which year that measure was introduced. It was since the war, I believe.

COMMISSIONER GIBSON: I think it was 1947, and it was increased a little later.

MR. ROW: I think we could well make the observation that that measure was only introduced during the post-war period of very high personal income tax. I think you would get a lot greater percentage of ownership of equities in Canada if personal income taxes were lower and the recipient of salaries or dividends was allowed to keep a little more of his own money and not have to hand so much of it over to governments. It used to be that a person who received a good salary, if he was thrifty, could become a wealthy man. Today that is not true. I do not care how big your salary is. If a Canadian receives money in a taxable form he cannot save enough to become a wealthy man today.

I think the big factor in Canadian ownership of Canadian equities would be if personal income taxes were on a substantially lower level.

COMMISSIONER MACKINTOSH: What you say is true of compound interest. I would guess there was more or nearly as much accumulation of personal wealth in the 50's as in any decade of Canadian history -- the major part of it, capital

increased more.

COMMISSIONER GIBSON: That is a conclusion you might draw, but I do not know who is disappointed.

MR. DOW: I forget in which year the measure was introduced. It was since the war I

COMMISSIONER GIBSON: I think it was 1945, and it was increased a little later.

MR. ROW: I think we could well make the observation that that measure was only introduced during the post-war period of very high personal income tax. I think you would get a lot greater percentage of community of opinion to change if personal income taxes were lower and the problem of collection or dividends was allowed to keep a little more of its own money and not have to send so much of it over to Government. It used to be that a person who received a good salary, if he was thrifty, could become a wealthy man. They say that is not true. I do not care how big your salary is. If a Canadian must pay in a taxable form he cannot ever become wealthy man today.

I think the big issue in Canadian ownership of Canadian equities would be if personal income taxes were on a sustainably lower level.

COMMISSIONER MACKINNON: When you say is some of compound interest, I would ignore those was more or less as much consumption of persons wealth in the 30's as in any decade of Canadian history -- the major part of it, capital

gain.

MR. CAMPBELL: May I express a personal opinion? I feel that to some extent, and to quite a large extent, this problem arises because Canadians do not have the wealth that the Americans have. They cannot afford to take a chance, and the Americans knowing that over-all and on the average, with their abilities to analyse situations, they will win out in the end, they are, therefore, prepared to out-bid Canadians in equities.

MR. EDMONSTONE: And as soon as the Canadian sees a profit he will let his stock go to the United States too.

COMMISSIONER GIBSON: Speaking of the other financing arrangements of the mining industry, -- I should not ask this question, but have you any comment to make about your financing arrangements with the banks?

MR. EDMONSTONE: I wish they would not say "no" so often.

COMMISSIONER BROWN. Assume that question was asked by me, then you can say anything you want.

COMMISSIONER GIBSON: Have you any suggestions or recommendations to make in the area of financing through banks and insurance companies, and various other means?

MR. EDMONSTONE: Probably the banks are a little too hobbled on the question of short-term credits. Certainly, at the present time they appear to be.

MR. CHAMBERLIN: May I express a personal opinion? I feel that to some extent, and to quite a large extent, this problem arises because Canadians do not have the vacation and the American have. They cannot afford to take a choose, and the Americans knowing that over-all and on the average, with their facilities to travise situations, they will win out in the end, they are, therefore, prepared to out-bid Canadians in equities.

MR. [illegible]: And as soon as the Canadian sees a profit he will [illegible] for his share to go to the United States too.

CHAIRPERSON CLARK: Speaking of the other Canadian [illegible] -- I should not ask this question, but have you any comment to make about [illegible] arrangements with the Canada?

MR. [illegible]: I wish they would not say "no" so often.

CHAIRPERSON CLARK: Leave that [illegible] was asked to me, then you can [illegible] your way.

[illegible]: Ring him and [illegible] through Detroit and various [illegible] to make it [illegible] to do [illegible] options open?

MR. [illegible]: I accept the point [illegible] to be.

COMMISSIONER MACKINTOSH: In what way do you mean, the availability of credit ?

MR. EDMONSTONE: The availability and the term, the certainty.

COMMISSIONER MACKINTOSH: Do you mean you want them longer?

MR. EDMONSTONE: Yes, I think that.

THE CHAIRMAN: You are interested in long-term money mainly for long-term development?

MR. EDMONSTONE: Yes, that is correct. Certainly, I think the banks are much more friendly to the mining industry and have a greater knowledge of it than they had, say, ten or fifteen years ago. They are now much more helpful.

THE CHAIRMAN: The insurance companies should be a source of supply?

MR. EDMONSTONE: Yes.

THE CHAIRMAN: Their attitude may be changing to some extent?

MR. EDMONSTONE: Yes.

COMMISSIONER GIBSON: Would you express any views on the operation of mining financing through the market? Have you any recommendations or suggestions there for improvement, through the mining market?

MR. CAMPBELL: Mining has become a more and more large-scale business, and the smaller outfits are gradually going out -- and that is not peculiar to mining alone. Therefore, I think the market may play a relatively smaller part than it has in the

may play a relatively small or part than it was in the
to buying alone. Therefore, I think the market
one (usually going out -- and that is the familiar
more long-term business, and the regular customer
business?

MR. CLAYBURN: Mr. Chairman, has become a more and
operations there for improvement through the years,
the market? Have you any recommendations or
views on the expansion of mobile-type [illegible]

COMMISSIONER [illegible]: Would you express any

to some extent?

[illegible]

MR. [illegible]: Yes.

THE CHAIRMAN: Their attitude may be somewhat

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JOHNSTONE MACKINTOSH: Do you mean you

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MR. [illegible]: The availability for the

You mean, the availability of credit ?

COMMISSIONER MACKINTOSH: In what way do

past, in the equity financing of a mining organization.

COMMISSIONER GIBSON: Do you think the arrangements, the way the equity financing is done in the mining industry is satisfactory? Have you any suggestions for improving this?

COMMISSIONER BROWN: I do not think any of these gentlemen, looking at the companies they represent, have gone to the market recently.

THE CHAIRMAN: I do not know, but perhaps at one time some of them have.

COMMISSIONER BROWN: I said "recently," sir.

MR. ROW: I think that the remark made a little while ago is the key to that. No one wishes to even try to do a major portion of substantial financing through equity money because of taxation reasons.

MR. EDMONSTONE: Your interest on your senior financing is, of course, a deduction from profits. The more you have of senior financing the more you can charge of your carrying expense to your operations as opposed to equity financing.

COMMISSIONER GIBSON: You gentlemen are talking about well established companies who have a real choice in the way they raise their funds. I was really asking about the mining market and stock market. The people who go there tend to be people who are starting up something new and are highly speculative, and so on. I wondered if you had any views on the form of that financing?

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and so on. I wondered if you had any views on the

meeting to exchange new and more hi-tech procedures,

the people who go there then to be people who are

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COMMISSIONER DIXON: You just mean are visit

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COMMISSIONER DIXON: Do you think the

past, in the equity financing of a mining organization,

MR. CAMPBELL: To a very large extent I think that is not mining.

THE CHAIRMAN: I have noticed when one of those fly-by-night ventures has become successful one of you gentlemen swallow it up quickly.

MR. MOCKRIDGE: I think it is almost impossible to get a venture of any size financed to completion without the participation of one of the larger mining interests.

THE CHAIRMAN: That may well be, but someone takes the original risk very often. But now, as I understand it, the large companies do a tremendous amount of exploration work, so that they initially bring into production a number of areas that might otherwise have been brought in by some smaller group. On the whole, is the total production of the mining industry continuing to increase steadily, or what is the whole picture at the present time?

MR. GILLANDERS: It is somewhat cyclical.

MR. WANSBOROUGH: There has been a steady increase ever since the war.

THE CHAIRMAN: The figures are here somewhere.

MR. MOCKRIDGE: If you will look at the various segments of the industry, as set out in that table, there are very great changes in some of those segments. For instance, the uranium became one of the largest factors in the mineral production. Now it is on the down turn. The iron ore has come up very substantially.

MR. DURRELL: It will be on a plateau, we

THE CHAIRMAN: I have noticed when one of those fly-by-night ventures has become successful one of you gentlemen swallow it up quickly.

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MR. MACDONOUGH: There has been a trend increase ever since the war.

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MR. DERRELL: It will be on a plateau, we

think, for the next few years, the iron ore production, with an increase a few years from now.

COMMISSIONER MACKINTOSH: There is a pretty strong form of competition?

MR. DURRELL: Yes, in iron ore it is terrific. The African and Asian countries have better grade ores than we have. They have very low costs and are operating under ideal climatic conditions; and as far as Europe is concerned it will be some years before we could be competitive. We will always sell some ore in Europe because we talk about our stability of government, and that is a bit of a factor, but the main factor is price. Although we would be in a position to export millions of tons a year, I am afraid it will be a very small amount after next year. With the Liberian ore coming in of excellent grade and a labour cost of ten cents an hour, against an average of, say, more than $3 here, it does not look too promising for the iron ore industry so far as exports are concerned to Europe.

The West Coast producers are fortunate in having a market in Japan, but that is not too great -- maybe three million or four million tons a year. Europe will be a net importer of iron ore to the extent of about 20, 30 or 40 million tons a year in five years' time. But I am afraid, owing to our inability to compete, our exports will not be what we had hoped for.

COMMISSIONER LEMAN: You would re-write the Paley Report, then?

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COMMISSIONER MACKINTOSH: There is a penalty
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COMMISSIONER Ivany: You would contribute two

MR. DURRELL: I re-wrote it back in 1952!

COMMISSIONER BROWN: Before we stray too far away from Mr. Gibson's question about the relationship to the banks, have you any comments to make on the legal ceiling on bank interest rates?

MR. CAMPBELL: The bank interest rates?

COMMISSIONER BROWN: The legal ceiling that exists on bank interest rates?

MR. DURRELL: I think, for the larger mining companies which borrow from the banks, that they do it in anticipation of a permanent financing, and the bank rate in that case, while important, is not necessarily a deciding factor in borrowing.

MR. EDMONSTONE: I do not see why banks should not be able to charge what interest rate they want to charge, if they need savings to re-loan.

THE CHAIRMAN: That is why they are here.

MR. EDMONSTONE: This is what commercial business is here to do.

COMMISSIONER MACKINTOSH: You would not modify that to read, "what rates they need to charge"?

MR. EDMONSTONE: There could be a question of public interest there, I suppose.

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MR. ROWCLIFFE: There could be a question of public interest there, I suppose.

MR. ZIMMERMAN: I think there is one point in Mr. Gibson's previous question that might be of some significance, that so far as the big companies are concerned the demand nature of bank financing on mining is probably quite satisfactory, but for a smaller company which wanted to go it alone the restrictions in Section 86 possibly could be broadened, as they have been in the case of the oil industry where you can have the security of the oil in the ground, and possibly there could be the facility of term loans rather than demand loans in isolated cases. I have no specific examples to offer, but I think it could be of advantage to some small mining companies.

COMMISSIONER BROWN: On this whole question of Canadian ownership and taxation and so forth, I noticed in the current issue of the Financial Post some reference to a Senate amendment to a taxation bill relating to a proposed change in taxation affecting Canadian subsidiaries that sell metals and ore to the United States. There was not very much detail in the Financial Post. Presumably you gentlemen know far more about it than appears in that paper. Have you any comments to make on this?

MR. WANSBROUGH: We do not know very much more than we have seen in the Financial Post, except that some of the United States subsidiaries operating in the mining field in this country are very much concerned with that particular amendment which, apparently, was slipped into the Senate tax bill during the last week, but which is still subject to amendment

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MR. MACDONALD: We do not know very much more than we have seen in the Financial Post, except that some of the United States subsidiaries operating in the mining field in this country are very much concerned with this particular amendment which, apparently, was slipped into the Senate tax bill during the last week, but which is still subject to amendment

by a joint committee of both houses. It is rather anticipated that it will not be passed, but if it is passed it will certainly cause alarm amongst the large United States subsidiaries operating in this country.

MR. EDMONSTONE: If it goes through it will do precisely what we tried to do back in 1957 and 1958 in Canada, and that is to discourage foreign investment. That will certain discourage it.

MR. WANSBROUGH: It will also do something that was incorporated in Mr. Kennedy's original tax proposal that was considered in the spring of last year, but that particular aspect of it was removed because of its unfortunate repercussions on other countries as well as Canada.

COMMISSIONER GIBSON: On this general question of credit would any of you gentlemen be prepared to give us your ideas as to how changes in credit conditions affect the mining industry. We have had two periods of relatively tight money since the war when interest rates went up sharply, and bank credit became harder to get, and so on. Would you care to give us an idea of how such a tightening condition affects the mining industry and, conversely, how an easing of monetary controls affects your industry. This would be very interesting to us because we are trying to study the effects of monetary and fiscal policy on the economy.

MR. CAMPBELL: I have no data to support my views and I can only give you my opinion which is probably influenced somewhat by my own company's exports, but I would say that at the most it would probably only

by a joint committee of both houses. It is perhaps anticipated that it will not be passed, but if it is passed it will certainly cause alarm amongst the large United States manufacturer operating in this country.

MR. DAWSON: If it goes through it will do precisely what we tried to do back in 1929 and 1930 in Canada, and that is to discourage foreign investment. That will certainly discourage it.

MR. HARKNESS: It will also do something that was incorporated in Mr. Kennedy's original tax proposal that was considered in the spring of last year, but that particular aspect of it was removed because of the unfavourable repercussions on other countries as well as Canada.

CHAIRMAN DAWSON: On this general question of credit would any of you gentlemen be prepared to give us your ideas as to how changes in credit conditions affect the sales? We have had two periods of relatively tight money since the war when interest rates went up sharply, and bank credit became harder to get, and so on. Would you care to give us an idea of how such a tightening down often affects the sales? Industry and, conversely, how an easing of monetary controls affects your business. This would be very interesting to us because we are trying to study the effects of monetary and fiscal policy on the economy.

MR. CHURCHILL: I have no data to support my views and I can only give you my opinion which is probably influenced somewhat by my own company's experience, but I would say that at this moment it would probably only

defer a capital expenditure programme rather than cancel it. If a mining enterprise is so close to margin that an increase in interest rates of one per cent or 2 per cent would affect it, then I think it is something that one would not go ahead with in any event. Another point is that the percentage of equity capital in mining is high relative to borrowed capital, and it is only in recent years that the mining companies have achieved greater structure that borrowed capital has become a feature.

So, what the future will bring, I do not know, but I think in the past, because of the relatively small percentage of borrowed capital and the need to be fairly certain that it is going to be a profitable operation, that therefore changes in the interest rate -- short-term changes, at least -- have not had a particularly important effect on new mining enterprises.

COMMISSIONER GIBSON: Do you know of any cases of deferments of capital expenditures in the big mines on account of high interest rates, and the difficulty in floating bond issues, and that sort of thing?

MR. CAMPBELL: I can only express an opinion from my personal experience. I think there are other factors which enter into it.

MR. EDMONSTONE: I think the indirect effect is just as important. Anything that is going to slow down the economy generally is certainly going to affect the mining industry. Because the mining industry is such a volatile industry, in any event, it is fairly quick to get the jitters.

COMMISSIONER GIBSON: But you are very dependent, in some branches, on export market conditions?

MR. EDMONSTONE: That is correct.

COMMISSIONER GIBSON: So the domestic economy does not effect you too much?

MR. EDMONSTONE: I am not thinking of ourselves; I am thinking of the rest of the mining industry.

MR. ZIMMERMAN: I would share Mr. Campbell's view so far as capital expenditure is concerned, although I think a more possible result of severe credit restrictions is in the field of exploration, and in the amount of money that might either be budgeted or put up by individuals for exploration. That would tend to dry up, which would have a later effect on the available properties for development.

MR. EDMONSTONE: That is the type of thing I mean.

COMMISSIONER GIBSON: Does it affect your attitude in dividend policy -- that is, as between when money is tight and when it is easy?

MR. CAMPBELL: I can only speak for my own company, and I think the answer is: No.

MR. MOCKRIDGE: I should think the answer to that in general would be: No.

MR. EDMONSTONE: On the other hand, I would think that if money is tight you are going to hang on to it tightly.

COMMISSIONER GIBSON: Do you mean you might pay a little less? On the other hand, if you pay a little more it might make your stock more attractive.

COMMISSIONER OLSON: But you are very dependent, in some branches, on export market conditions?

MR. MOORESTOWN: That is correct.

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MR. MOORESTOWN: I am not thinking of anyone; I am thinking of the year of the rising industry. I would share Mr. Campbell's view so far as capital expenditure is concerned, although I threw a more possible result of severe credit restriction is in the field of exploration, and in the amount of money that might either be employed or put up by individuals for exploration. That would tend to dry up, which would have a large effect on the available prospects for development.

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COMMISSIONER OLSON: Do you mean you might pay a little less? On the other hand, if you pay a little more it might make your book more attractive.

MR. EDMONSTONE: It might stop you doing some exploration you might want to do. You might hold it from dividends and spend it on explorations.

COMMISSIONER GIBSON: Another question I have is this: We have been told by the security analysts and, I think, others, although they were not very specific and definite about it, that we should have in this country full and continuous disclosure of finances, particularly from the larger companies -- the companies listed on the stock exchanges. Have you gentlemen any views you would like to express on this subject?

MR. GILLANDERS: I am not quite sure that I understand what you mean by continuous disclosure.

COMMISSIONER GIBSON: Well, quarterly statements were suggested -- quarterly profit and loss statements, and statements of sales.

MR. ZIMMERMAN: Do you mean by "full disclosure" that they should be in the same form as the present annual statements?

COMMISSIONER GIBSON: Perhaps with not as much detail. Some of the larger companies do this now.

MR. MOCKRIDGE: I think the trend has been towards that.

MR. CAMPBELL: A lot of these statements can cover such a short period of time that they have to be highly qualified in some cases, and they can do as much harm as good.

COMMISSIONER GIBSON: Do you have an industry view on this subject?

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COMMISSIONER GIBSON: Do you have an industry

MR. WANSBROUGH: We have discussed this amongst ourselves, Mr. Gibson.

COMMISSIONER LEMAN: Mr. Chairman, it is just a coincidence -- it was not intended -- that the next witness coming before us in just a few moments is the Export Credits Insurance Corporation. Does your industry rely on that corporation to any extent? Have you had any export credits problems in relation to very sizable exports, or to the sizable portion of your sales which are exports?

COMMISSIONER MACKINTOSH: I think the gold mining industry, at least, has not.

COMMISSIONER LEMAN: Yes, we could probably except the gold mining industry.

MR. CAMPBELL: I think the answer to that is: "No" because generally our commodities are purchased by countries which can well afford to pay for them.

COMMISSIONER LEMAN: But, in general, do you think it would be true to say that the metals exports are largely sold on very short credit terms?

MR. CAMPBELL: I think they are generally sold on cash terms.

COMMISSIONER LEMAN: So that you have not had very much in the way of export credits problems?

MR. CAMPBELL: Underdeveloped countries do not purchase our products.

MR. ZIMMERMAN: The problems we have there are really in the smaller volume of rarer metals and some industrial minerals. There are difficulties in that area, but they are very minor compared with the whole

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some industrial minerals. There are difficulties in
that area, but they are very minor compared with the world

picture.

THE CHAIRMAN: Gentlemen, that concludes the discussion. We appreciate very much your assistance.

MR. WANSBROUGH: Mr. Chairman, may we, in turn, say that we have appreciated very much this opportunity of discussing these matters with you.

THE CHAIRMAN: It has been a very beneficial discussion.

--- A short recess.

SUBMISSION OF

EXPORT CREDITS INSURANCE CORPORATION

APPEARANCES

H.T. Aitken	-	President and General Manager, Export Credits Insurance Corporation
A. W. Thomas	-	Vice-President, Export Credits Insurance Corporation
D. C. Taylor	-	Chief of Finance Division, Export Credits Insurance Corporation.

THE CHAIRMAN: We now have before us the Export Credits Insurance Corporation. Mr. Aitken, are you making a statement, or have you nothing to add to what is in your brief?

MR. AITKEN: No, sir.

COMMISSIONER GIBSON: Mr. Chairman, perhaps I might ask a few general questions to begin with. I wonder, Mr. Aitken, if you would care to give us your general ideas of where export credit insurance fits into our problems of getting a better balance in our international payments. Do you regard expanding our exports as a fairly important element? Can you give us some idea of the magnitude and significance of it?

MR. AITKEN: I will be very pleased to, sir. We have been in business since 1945. We operate under

the Export Credits Insurance Act, which was passed in 1944. We issued our first policy in September, 1945. Since that time we have insured close to $1,100,000,000 worth of exports.

We insure short-term consumer goods sold on 30, 60 or 90 days, up to a maximum of 180 days credit. We insure capital goods sold on medium term credit extending to a maximum of five years after delivery. The main purpose of the corporation is to assist in increasing Canada's exports by providing Canadian exporters with protection against non-payment by foreign buyers, such as non-payment arising from both credit and political risks involved in foreign trade. Credit risks are such things as the possible insolvency of the buyer or, alternatively, default in payment on the part of the buyer without his having actually become bankrupt or insolvent. Political risks are the possible inability of the buyer to obtain the necessary foreign exchange to transfer to Canada. They can also be the imposition of import restrictions which prevent the buyer from taking possession of the goods he has previously ordered.

So, under our policies we protect the exporter against non-payment due to both credit and political reasons. The exporter is thus encouraged to expand his export trade, and to take on risks in other countries where he may not be too familiar with economic conditions. He may be fearful of non-payment. He may do all he can to check on the credit standing of the buyer, but he has no control over it, nor has he any specific knowledge of the paying policy of the country.

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COMMISSIONER GIBSON: You do not protect him against the refusal to pay on the part of the buyer on the grounds that the goods are not as they should be?

MR. AITKEN: We don't cover repudiation or refusal to accept delivery of goods on the part of the buyer and we consider that we help the exporter to protect himself against that risk by pointing out to the exporter that he should obtain up-to-date credit reports on the buyer that would justify him granting credit to the particular buyer.

As an example of the basis on which we believe we have been able to help exporters, take the exporter who feels that all the capitalization he can afford to have is $10,000 outstanding in a particular country. Well, if he has no insurance he has $10,000 at risk, and if he takes out a policy with us we cover him up to 85 per cent of that $10,000, so his risk is only $1,500, and he can afford to increase his exports six times. He can have $60,000 outstanding provided he can finance, and with our policies he can obtain financing, so on outstanding accounts receivable of $60,000 his risk is only 15 per cent of that, or $9,000, which is less than he had at risk when he was selling only one-sixth as much, so, having insurance, an exporter can expand his export trade.

COMMISSIONER GIBSON: What sort of proportion of our export trade is insured?

MR. AITKEN: Well ---

COMMISSIONER GIBSON: Could you give us an idea?

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COMMISSIONER GIBSON: What sort of procedure of our export terms is this?

MR. AITKIN: Well ---

COMMISSIONER GIBSON: Would you give us an

MR. AITKEN: Last year we insured $130 million of exports and Canada's total exports were between $5 billion and $6 billion, so we had perhaps 2 per cent, which seems rather a miniscule figure but, nevertheless, the corporation was set up to provide backing which the exporter couldn't obtain through other sources. There is a commercial insurance concern which will insure domestic credit risks and credit risks in the U.S.A. but E.C.I.C. will not, as a rule, insure sales to the U.S.A., so you have to exclude two-thirds of Canada's exports, I would say, when you are considering the volume, and the percentage of exports that we cover.

If you take, say, $5 billion as the total exports -- and it is higher than that now -- if two-thirds are to the United States, you are left with about one-third insurable. Of that one-third, which would be, say, a billion seven -- certainly more than half and perhaps up to three-quarters is covered by irrevocable letters of credit, confirmed letters of credit, so that the exporter when he ships he gets paid and there is no risk for him or for Canada, and then there is also quite a volume of business done between affiliated companies; a parent to a sub or a sub to a parent, where the only risk is the one of transfer.

Also included in Canada's export figure are shipments to entities such as NATO, et cetera, and shipments under the Colombo plan. We think currently we are running somewhere between 30 to 50 per cent of the maximum volume of business which we could be

called upon to insure under today's conditions of credit granting in international trade; 30 to 50 per cent of the total insurable business.

COMMISSIONER GIBSON: But being on the margin a lot of this trade might not otherwise have been done?

MR. AITKEN: That is our view.

COMMISSIONER GIBSON: Is the proportion of trade that you are financing -- the insurable type of trade -- tending to increase?

MR. AITKEN: Yes. Two years ago we had 247 policyholders; today we have 347. We are up 100 policyholders in the last two years.

COMMISSIONER GIBSON: Is the geographical distribution tending to broaden?

MR. AITKEN: Of the exporter?

COMMISSIONER GIBSON: Of the insurance.

MR. AITKEN: The vast bulk of the exporters which we insure are in Ontario and Quebec.

COMMISSIONER GIBSON: I am thinking of the places they sell to.

MR. AITKEN: I think our experience is that one-third of what we insure goes to Latin America and one-third to Commonwealth markets and one-third to the rest of the world, and that percentage has held fairly consistently throughout the years.

COMMISSIONER GIBSON: Well now, to turn to a little different aspect of this matter, what about the distinction between export credit insurance and long-term credits? We draw a line of five years.

MR. AITKEN: Yes.

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granting in International Trade; 30 to 50 per cent of
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COMMISSIONER GIBSON: But going on the margin
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MR. ALTMAN: That be one view.

CHAIRMAN GIBSON: Is the proportion
of trade that you are financing -- the Lummox's
type of trade -- tending to increase?

MR. ALTMAN: Yes, two years ago we had
only polyethylene; today we have [illegible]. We are up
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straw-boaters tending to [illegible]

MR. ALTMAN: I hope our experience is that
one-third of what we insure is open to Latin America and
one-third to Communist countries and one-third to the
rest of the world, and that percentage has held
[illegible]

COMMISSIONER GIBSON: Well now, is there
is a little difference between of risk factor, what
about the distinction between export credit insurance
and long-term credits. We have a line of five years,

COMMISSIONER GIBSON: And we say that after that you can apply for a government loan if you have a special reason to fit certain circumstances. From the government's point of view there is a real difference; in one case the government puts up the money and in the other case it doesn't but it has the liability in both cases. From the exporter's point of view, perhaps it doesn't make very much difference providing you finance the insured as well. Do you have any views on this? Is the five years the right cut-off point?

MR. AITKEN: There is nothing magic about the period of five years, admittedly. However, when you do get up to five years -- and this is a very long time, particularly for an exporter of capital equipment to have an outstanding accounts receivable -- but under our Act we can insure only the exporter and therefore he has to carry a portion of the risk. It remains on his books as a somewhat frozen accounts receivable.

There is nothing magic about five years; perhaps the maximum period should be either three years or seven years, and in the case of heavy expensive aircraft, such as the Canadair C.L.44, which costs $5 million, or in the States the Boeing 707, which can cost up to $10 million, the credit terms of seven years are considered appropriate but, by and large, for capital equipment where the supplier carries a portion of the risk and carries the accounts receivable on his books, it is our view and it is the internationally accepted view that five years' credit is the maximum that should

COMMISSIONER GIBSON: And we may then also
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be accorded.

It is only where credit terms longer than five years are clearly necessary, desirable, justifiable, that financing is provided from another source; this is a source outside credit insurance, and it is handled in our long-term export financing division in Canada.

I might mention that the Corporation in its insurance activities is a member of the Berne Union which was formed in 1934, and eighteen countries are members, all the major exporting capital equipment nations of the western world outside the Iron Curtain and with the exception of Japan. Japan is the only country not a member of that organization.

COMMISSIONER GIBSON: Would you say that the risk -- I suppose by definition the risk is greater the longer the term. Is it in the nature of the transactions that are financed by government loans that they are riskier or more out of the ordinary line of export business? I realize, for example, that loans to Iron Curtain countries would be financed that way. I am still not clear on this.

MR. AITKEN: Long term financing is available under Section 21A of the Export Credits Insurance Act to enable Canadian exporters to compete with exporters in other countries in cases where these other countries have financing facilities which provide financing for capital projects through an entirely new plan.

As an example, last year -- a year ago last month -- we agreed to finance a paper mill in Chile and

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MR. ALLEN: Long term financing is available under Section 21A of the Export Credits Insurance Act to enable Canadian exporters to compete with exporters in other countries in cases where these other countries have financing facilities which provide financing for capital projects through an entirely new plan.

As an example, last year -- I went on last month -- we agreed to finance a power mill in Cuba and

this whole paper mill will cost $21 million and we agreed to pay out the financing for the foreign exchange costs of that paper mill. The machinery is being made in Canada, the plant is being engineered in Canada, and we are paying the manufacturer and the engineer cash as they deliver and perform; as they manufacture, deliver and perform.

COMMISSIONER GIBSON: It is a loan under Section 21A.

MR. AITKEN: Yes, and repayment terms extend to fifteen years from the date of contract. It will take about three years to get the plant underway and then the buyers have -- or the borrowers -- have twelve years to pay off.

Now, that is the type of thing that is financed by entities such as the World Bank or the Export-Import Bank, and it is in order to help Canada's exporters match such terms and compete for international project business that the facilities of Section 21A were made available.

COMMISSIONER GIBSON: Do you find that there is a very distinct borderline between the two ways of doing it at times?

MR. AITKEN: Sometimes one tends to spill over into the other, but we have set certain criteria which we follow. The government has decided that it would be inappropriate to provide long-term financing for anything less than $2 million for a single order, and if you have an order where $500,000 or a million or $1½ million were involved, then supplier credit terms would be more

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were involved, then supplier credit terms would be more

appropriate. That would be up to a maximum of five years rather than the long-term, which would be ten to fifteen years. That is one of the criteria.

Another is that long-term credit must clearly be available or have been available for similar projects in similar countries on similar terms. In other words, we match what is available in other countries, but we don't want to start any credit race by going beyond what is generally available from international lenders.

COMMISSIONER GIBSON: But you think we do a pretty fair job in financing?

MR. AITKEN: Yes.

COMMISSIONER GIBSON: You are talking about the loans rather than insurance?

MR. AITKEN: I think we are equally competitive on an insurance basis, too.

COMMISSIONER GIBSON: And would there be any exceptions to that; are there any countries that are particularly aggressive in this now?

MR. AITKEN: Well, the Canadian exporters frequently make allegations that exporters in other countries have facilities available to them, or that insurance companies in those countries are more lenient in their credit granting than we are, but when you get over there the exporters of those countries complain to their insurance organizations that we are too easy. The Italians complain about the Germans and the French and the Canadians, and the Canadians complain about the U.K. and the French and the Germans.

COMMISSIONER GIBSON: You are always com-

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COMMISSIONER GIBSON: Don you think we do a pretty fair job in Canada?

COMMISSIONER GIBSON: You are talking about the loans no later than January.

MR. ADAMS: I think we are equally competitive on an interest basis, too.

COMMISSIONER GIBSON: And would there be any exceptions to that; are there any countries that are particularly aggressive in this way?

MR. ADAMS: Well, the Canadian experience is that we have traditionally had available to them, or used in those countries the more liberal in their credit wording than we are, but when you get over there the experts of these countries tend to think insurance organizations that we are too easy. The Italians complain about the German and the French and the Canadians, and the Canadians complain about the U.K. and the French and we certainly,

COMMISSIONER GIBSON: You are always com-

paring specific cases, I suppose.

MR. AITKEN: Yes, we are in close contact on a weekly basis -- on a monthly basis and on a correspondence basis with all our colleagues and, of course, some of them, particularly; the largest insurers are the British, the French and the Germans. In the United Kingdom they have a tremendous volume, of export credits insurance business. In 1961 I think they did £ 800 million.

COMMISSIONER GIBSON: That was because of the nature of their exports?

MR. AITKEN: Yes.

COMMISSIONER GIBSON: That is a great deal more than we do.

MR. AITKEN: Yes, but because of the nature of their exports they have a tremendous volume of experience, and any problem which we have or any request we have for credit or approval of specific payment terms, they have probably had similar requests twenty, thirty, fifty times, and, as I say, we are on a first name basis with all of our colleagues and we maintain a mail exchange of information which is very helpful to us as very small operators as compared with what goes on in the U.K., France and Germany.

COMMISSIONER GIBSON: So, are you concerned about the competitive development of this thing leading to looser and looser and longer and longer terms, or do you think ---

MR. AITKEN: We think they are fairly well -- I don't like to say "controlled", but they are in hand,

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and if we don't believe they are the sort of terms of credit for a particular commodity or a particular type of equipment, we say that we follow the custom of the trade, and if an exporter's businessis normally done on thirty, sixty or ninety day terms, we will insure on those terms.

If an exporter who sells fresh eggs comes in -- and they are normally sold by a letter of credit or cash against documents, or perhaps where trade has been going on for years, ten to thirty days' credit might be correct. If an exporter came in and said he wanted six months' credit we wouldn't insure.

COMMISSIONER GIBSON: What about the Berne agreement; does it mean much with governments making long term loans?

MR. AITKEN: The Berne Union recognizes financial credits but the financial loans are quite outside the scope of the Berne Union; it is concerned with insurance, but as far as credit is concerned the Berne Union are agreed that the maximum term export credits insurers can insure is -- for all classes of equipment, the heaviest of capital equipment with the exception of aircraft -- is up to five years.

COMMISSIONER GIBSON: But if you can get a loan from your government to do the same job for eight years, isn't that direct competition with the insurance?

MR. AITKEN: In effect it is. However, as I said, long-term loans are generally for substantial projects and as a rule in developing countries where the

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of the trade, and if an exporter's bank would normally

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MR. AITKEN: It might be, however,

as I said, long-term loans are generally for capital

projects and as a rule to developing countries whereas the

need for long-term financing is clearly evident, where the project is one which -- and is a hydro electric development or the one in Chili, an entire paper mill and, for example, just a few weeks ago we insured the sale of paper mill equipment to a Latin American country where papments are spread over five years. The exporter is arranging the financing and we are insuring 85 per cent of the risk and the business is being done on those terms.

COMMISSIONER GIBSON: Do you think that the Berne agreement serves a useful purpose any more?

MR. AITKEN: I certainly do; it is of great value to us.

COMMISSIONER GIBSON: So that you at least know what the general terms are on the insurance?

MR. AITKEN: Yes.

COMMISSIONER GIBSON: But do you satisfy yourselves on what the competition is doing on loans?

MR. AITKEN: Oh.

COMMISSIONER GIBSON: Is there any understanding there?

MR. AITKEN: It is currently under discussion in three areas. First of all, we have had some discussions on the question under the Berne Union and we recognize it is really outside our competence.

I should point out that it is a bit of an anomoly that long-term financing is handled by the Export Credits Insurance Corporation. We have in the United States the Export-Import Bank which started off providing long-term financing and is now into

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Now, the members of the Berne Union are members as credit insurers and only some of these members handle long-term financing.

In the U.K. the Export Credits Guarantee Department, which is the same as we are here, under Section 3 of their Export Guarantees Act handles long-term financing and where the government decides to make a loan on long-term credit to a developing country, then it is handled through E.C.G.D.; they are, in fact -- they administer the loan but they don't negotiate it or grant it, it is merely handled by them because of the fact that Section 3 of their Act designates them as the body which handles it.

Under Section 21A of our Act you appreciate that while we administer the loans for the credits, that they are granted only on the basis of cabinet directive; that is, an order in council which specifically authorizes the particular credit.

COMMISSIONER GIBSON: What I am trying to get at is are you really satisfied that you are really in competition in that field as well as in the insurance

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COMMISSIONER GILSON: What I am hoping to get at is are you really satisfied that you are really in competition in that field as well as in the insurance

field, and how do you satisfy yourselves?

MR. AITKEN: I have referred previously to discussions going on in the Berne Union concerning long-term financing. Now, there is a committee set up within the O.E.C.D., the Organization for Economic Co-operation and Development, and Mr. Thomas has just returned from a meeting in Paris where a group of insurance experts met to discuss both insurance and long-term financing, and in O.E.C.D. all the members of O.E.C.D. exchange information through the secretariat on long-term credits granted to developing countries and that information is available to us and we see what the others are doing, and we feel that the facilities in Canada are at least as good as those available anywhere else.

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COMMISSIONER MACKINTOSH: I should like to ask one or two questions. What do your customers think is lacking in legislation?

MR. AITKEN: With regard to legislation?

COMMISSIONER MACKINTOSH: I mean the operation as well.

MR. AITKEN: The operation?

COMMISSIONER MACKINTOSH: Yes.

MR. AITKEN: Well, we have received surprisingly few complaints. Can you think of any major complaints, Mr. Thomas?

MR. THOMAS: No. We do get the odd one about selected risks. We do have a summary of the policy-holders we lost and the reasons for their lack of interest. If I may I should like to give you the breakdown. Out of a total of 302 policy-holders who did not renew their policies, 247 went out of the export business. Only 11 wanted to select their risk. Seven were unahappy because we would not cover repudiation, and 11 said that our rates were too high. Twenty-six had various other reasons. Therefore, as you can see, the vast bulk were out of the export business.

MR. AITKEN: The major complaint, as Mr. Thomas has suggested, is the fact that one of our principles is that the exporter, in order to take out export credit insurance, must give a broad spread on his business and he cannot select individual risks. If he wants to insure to the Argentine and Chile, for example, he must also insure to the United

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MR. AITKEN: The major complaint, as Mr. Thomas has suggested, is the fact that one of our principles is that the exporter, in order to take out export credit insurance, must give a broad spread on his business and be cannot select individual risks. If he wants to insure to the Argentine and Chile, for example, he must also insure to the United

Kingdom and Germany. We automatically exclude sales to the United States. Sales made against irrevocable letters of credit are excluded, but all the other business is supposed to be insured. If an exporter wants to exclude a particular market we will always agree to discuss it and provided that the remaining markets give us what is in our view a reasonable spread of risk we will agree to the exclusion of a market. In our view, however, when an exporter does that he frequently selects against himself. That may be the one market where he has a loss and he blames us for not requiring him to insure everything.

COMMISSIONER LEMAN: Has there been any change at all in this rule about broad coverage? In earlier days were you more strict on this score?

MR. AITKEN: Yes. Initially we started off saying that the exporter must insure everything. Then we had representations from some exporters that the buyer to whom they sold in, for example, Australia, was one with whom their company had been dealing for 50 years and they wanted to insure all their other business but not the Australian buyer. So, we have endeavoured to be as flexible as possible commensurate with getting what we consider to be a reasonable spread of risk. But, in our view, an exporter who is sold on the export credit insurance principle should be sold on the realization that no matter what protection an exporter takes he cannot protect himself against the unexpected, accidental, unanticipated loss which might arise through death,

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CHAIRMAN DEVAN. Has there been any change at all in this rule about broad coverage? In addition have were you more active on this score?

MR. ALDRICH. Yes. Initially we insured all selling that the exporter may desire everything. Then we had experiences with some exporters that the buyer to whom they sold in, for example, Australia, was one with whom their company had been dealing for 50 years and they wanted to insure all their other business but not the Australian buyer. So, we have endeavored to be as flexible as possible commensurate with getting what we consider to be a reasonable spread of risk. But, in our view, an exporter who is sold on the export credit insurance and people should be sold on the realization that no matter what protection an exporter takes he cannot protect himself against the unexpected, accidental, unanticipated loss which might arise through dumb,

calamity, business depression, and so on. In other words, an exporter, no matter how careful he is in the matter of credit risks, cannot foresee or cover or protect himself except through us. In the initial stages many exporters asked for the exclusion of the United Kingdom. Our first political loss was in the U.K. If ~~an exporter~~ has, say, 11 markets and wants to insure 10, to us it is a little bit like saying, "I have an 11-roomed house but I just want to insure 10 rooms against fire, not all 11."

COMMISSIONER LEMAN: Was it a political loss? What happened?

MR. AITKEN: The United Kingdom was allowing imports of certain items under an open general license and in 1947, you may recall, they ran very short of foreign exchange and they cancelled the open general license. We had insured an exporter who was making certain goods under a contract and the goods could not be shipped, so we had to pay for them.

COMMISSIONER BROWN; It is on the same general principle that you cannot get flood insurance on your house because the only people who will buy flood policies are people who live next door to rivers.

MR. AITKEN: Yes.

COMMISSIONER MACKINTOSH: What are the main reasons for most of your refusals to insure?

MR. AITKEN: We do not refuse. I would say that in 99 per cent of the cases where people come to us for insurance, the exporter is experienced in the trade and comes to us with a transaction which

he himself feels is reasonable. We get very few hair-brain requests, very few. . I would say that by and large we agree to cover prospective sales. We are concerned with two matters. Are the terms of payment proposed reasonable and are we going to get paid?

MR. THOMAS: There is one point I should like to make about refusals in the broader sense. We would refuse to insure an exporter who is starting up for the sole purpose of breaking the terms of the trade. For instance, if we insure a lot of fish exporters who sell on very short-term credit, mostly on documentary draft, if somebody in that particular area decided he wanted to go out and sell a lot of fish and give 60 to 90 days credit, we would agree to insure him on a documentary draft basis but not on a 60 to 90 days credit basis.

MR. AITKEN: One complaint made by exporters of capital equipment, particularly exporters who are under-capitalized or who have, let us say, insufficient capital to handle a particular order of a substantial size, is that we will not give them non-recourse coverage. In other words, the Act says we can insure an exporter. Let us say that an exporter who has $200,000 capital can get an order for $5 million. Let us say we would insure him, that we are satisfied he could produce. We are interested in the capacity and capability of the exporter, just as we are in the credit terms involved and in the capacity and capability of the buyer

fair-trade volume," very low. I would say that by and large we appear to occupy precarious ... We are concerned with two matters. (1) the terms of payment proposed reasonable and are we ready to get paid?

MR. THOMAS: There is one point I'd would like to make about refusals in the previous years, we would refuse to issue an exporter who is starting up for the sole purpose of breaking the terms of the issue. For instance, if we issue a lot of fish exporters who sell on very short-term credit, mostly on documentary draft basis but not on a 60 to 90 days credit basis. If in that particular case wanted to go out and sell a lot of fish and give 60 to 90 days credit, we would agree to issue him on a documentary draft basis but not on a 60 to 90 days credit basis.

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in the foreign country to pay. Let us say we insure a $5 million order and the payment terms we might be prepared to agree to would be, say, 10 per cent cash with the order, 10 per cent on delivery and the balance spread over five years after delivery. Well, we would insure 85 per cent of the amount owing by the buyer, so there would be about $4 million owing. The goods are shipped and the exporter has to carry a risk of 15 per cent, and 15 per cent of $4 million if $600,000. But he has only $200,000 capital. He says, "If you could give me 100 per cent cover so that once I ship I get paid, I would not have to worry any more and I could do more business." Our reply is, "You have not got sufficient capital to handle that type of business."

MR. TAYLOR: They have also expressed some concern that the financing arrangements they can make through the normal banking channels on the basis of promissory notes, discounted on a with recourse basis, remains on their balance sheet as a continuing, contingent liability impairing their credit position for other operations.

COMMISSIONER MACKINTOSH: You are speaking of financing they might get from a bank?

MR. TAYLOR: Yes.

COMMISSIONER MACKINTOSH: Or through the Export Finance Corporation?

MR. TAYLOR: Yes.

COMMISSIONER MACKINTOSH: You mentioned the

sections which apply to capital goods. How do you distinguish capital goods?

MR. AITKEN: Well, producer goods, goods which produce, such as heavy machinery, locomotives, and heavy goods like bridges.

COMMISSIONER MACKINTOSH: Producers' durable goods?

MR. AITKEN: Correct.

COMMISSIONER GIBSON: What about steel girders?

MR. AITKEN: I must say we have never been asked to insure steel girders as such.

COMMISSIONER GIBSON: That line of product must be difficult to insure?

MR. AITKEN: Yes. Let me give you an example. Let us suppose a foreign contractor is building a bridge and he wants to purchase the nuts and bolts from Canada and he says, "These are capital goods which are going into this bridge." We would not insure on the basis of medium-term credit. We would say that it would have to be paid in 60 to 90 days. However, if the Canadian exporter was providing all the girders, the nuts, bolts and everything going into the bridge, we would insure the whole complex on a medium-term credit basis. We would insure, for instance, gas tanks sold abroad, on medium-term credit, but we would not insure the steel plate that might go to a foreign country to be made into forms to make the gas tanks. We would not insure that on medium-term credit. Usually that would be

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sold on a short-term credit, supplier-term credit.

COMMISSIONER MACKINTOSH: Let us return to your bridge. Let us say that one Canadian exporter provides the girders, another Canadian exporter provides something else, and so on, so that the whole bridge is being supplied from Canadian sources. What would happen in that case?

MR. AITKEN: We have never had such a case. We would suggest that a consortium be formed.

MR. THOMAS: We are working on a case at the present time for a Latin-American country -- this does not concern a bridge -- where there is a whole new plant being built. It is under Canadian engineering supervision, and the Canadian engineers approached us on this proposal which they wanted to break down amongst a number of Canadian suppliers. We accepted this, but if it had been on an individual basis with only a portion coming from one Canadian supplier we probably would not have gone along to the extended term we are giving for the over-all project, which is broken down into a number of pieces.

MR. AITKEN: It is because in this case we know that everything is coming from Canada that we are insuring the individual exporters, whereas if one exporter had come along to us and we had no knowledge of the fact that everything was coming from Canada we might have turned him down.

COMMISSIONER MACKINTOSH: Taking your bridge example, and assuming that the steel for the

sold on a short-term credit, supplier-term credit.

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bridge example, and assuming that one asset for the

bridge was a heavy capital expenditure which you would expect to finance over a considerable period, why do you put such emphasis on the whole bridge? I can see your reasoning with respect to the nuts and bolts. Do you say that they ought to be able to pay for them in a short time and that it is not worth it, perhaps, but with respect to a big steel order, including the whole bridge, why not?

MR. AITKEN: Because the item in itself is not what we would describe as a sophisticated item of heavy capital equipment. The trouble is that if we were to agree and we were asked to insure the sale of steel plate for a bridge on, say, three years' credit, it would be quickly known internationally that Canada had exported steel on three years' credit and the exporters in other countries would be little concerned with the end use but would complain to their governments, to their export credit insurers, that Canada was selling an item, essentially a consumable item, on capital goods credit terms of medium-term credit, whereas the vast bulk of trade in that commodity is done in short-term credit.

COMMISSIONER MACKINTOSH: Your main objection is that this is beyond the customary terms of the trade?

MR. AITKEN: That is correct.

MR. THOMAS: The international terms.

MR. AITKEN: We say and we believe that we do not try to set or dictate credit terms. We follow

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the custom of the trade.

COMMISSIONER MACKINTOSH: I gather from what you said earlier that you are satisfied, as developed by experience, E.C.I.C. has become an important tool or resource in the extending of our exports?

MR. AITKEN: We think that is so.

COMMISSIONER MACKINTOSH: I am interested in that, for I believe I made the first crude draft of the legislation under which it operates. I may say that the finished legislation bore little resemblance to my initial attempts, but I am glad something grew up.

COMMISSIONER BROWN: You mentioned that you do not have much by way of complaints. We have a brief here from the Canadian Manufacturers' Association, which organization will appear before us next week, in which they mention several points. You have answered some of them already. They suggest among other things that the Export Credits Insurance Corporation should be as liberal as possible in its determination of the borderline between goods which are eligible for medium-term coverage and those which are not. I think you have answered that. They have another suggestion here about co-insurance, and they make this statement:

> "The present Canadian limit is 85 per cent, but export credits insurers in some other countries are prepared to cover as much as 95 per cent."

Would you care to comment on that?

the custom of the trade.

COMMISSIONER MACDONALD: I gather from what you have earlier that you are satisfied, as developed by experience, B.C.L.C. has become an important local resource in the stimulating of our export

MR. ALDRED: We think rest is on

COMMISSIONER MACDONALD: I am thinking in that, for I believe I made the first crude start of the legislation under which it operates. I may say that the British Legislation does similar

[illegible]

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You do not have much by way of commercial [illegible] have a right [illegible] the Canadian Provincial [illegible] [illegible], where [illegible] with [illegible] we [illegible] next week; in which they maintain several [illegible] You have already [illegible] [illegible]. They [illegible] [illegible] [illegible] [illegible] Corporation should be [illegible] [illegible] its [illegible] of the potential [illegible] which are eligible for [illegible] [illegible] those which are not. I think you have answered [illegible], have another suggestion more [illegible] and they make this statement:

"The present Dominion Limit is [illegible] [illegible] per capita [illegible] [illegible] [illegible] [illegible]

MR. AITKEN: Yes. The United Kingdom, for example, will in certain countries cover up to 95 per cent for the transfer risk while limiting the credit risk to 85 per cent. Again, in other countries, particularly in Germany, for example, which varies its co-insurance proportion, having regard to its view of the risk involved in the particular country. In a certain Latin-American country, which I will not name, they have cut their co-insurance proportion to 70 per cent. We have 85 per cent across the board, and this is for a multiplicity of reasons, a couple of which are that in our view it is frequently difficult to distinguish between a credit loss or a political loss. The two are frequently intermingled, and while it is possible by definition to say that you will pay "X" per cent for one type of loss and "Y" per cent for another, we feel it is from the point of view of simplicity more appropriate to have a uniform percentage of cover for all types of loss. Now, there is admittedly nothing magic in the figure of 85. Perhaps 70, 75, 80 or 90 would be more appropriate. In the case of manufacturers, their gross profit would be in the 15 per cent area, but in the case of merchant exporters their gross profit on a particular transaction might be 5 per cent or as low as 3 per cent, so that the 15 per cent that the exporter is required to carry cannot really be said to bear any direct relation to his profit or risk in the transaction from the point of

MR. ACHESON: Yes. The United Kingdom, for example, will in certain countries cover up to 95 per cent for the transfer risk while limiting the credit risk to 85 per cent. Austria, in other countries, particularly in Germany, for example, [illegible] its co-insurance proportion, having regard to the view of the risk received in the particular country. In a certain Latin-American country, which I will not name, they have our basic co-insurance proportion to 70 per cent. We have 85 per cent across the board, and this is for a multiplicity of reasons, a couple of which are that in our view it is frequently difficult to distinguished between a credit loss or a political loss The two are frequently intermingled, and while it is possible by definitions to say that you will pay "X" per cent for one type of risk and "Y" per cent for another, we feel in the round or view of capability more appropriate to have a uniform percentage of cover for all types of loss. Now, there is obviously ceiling room in the figure of 95%. Perhaps not 75, 80 or 90 would be more appropriate. In the case of manufacturers, their gross profit would be in the 15 per cent area, but profit on a particular transaction might be 5 per cent or as low as 3 per cent, so that the 15 per cent that the exporter is required to carry cannot really be said to bear any direct relation to profit or risk in the transaction for the gains of

his profits. We want to retain the exporter's continuing risk in a transaction right up until it is finally paid. To the extent we decrease his proportion of co-insurance, his interest in getting payment by the ultimate buyer lessens and we think that 85 per cent across the board with a 15 per cent co-insurance ratio is reasonable. It is true that in the United Kingdom they have gone to 95 per cent in certain cases, but I understand it is quite selective.

MR. THOMAS: Even in the United Kingdom they do go down to 75 per cent, and at the present time they are only giving a 75-25 ratio for quite a number of countries.

MR. AITKEN: They will go to 95 per cent in certain areas, but they do vary it. As Mr. Thomas has said, they insure on a 75-25 basis in some countries.

MR. THOMAS: Whereas we are constant. We have gone below 85 per cent in some instances where, and chiefly where, the exporter has made a substantial profit. We have gone as low as 60 per cent.

MR. AITKEN: That is, we have given 60 per cent, and the exporter carries 40 per cent of the risk.

COMMISSIONER BROWN: This is because of his substantial profit?

MR. AITKEN: That is right.

COMMISSIONER BROWN: There is another suggestion:

> "It is recommended that the Government should follow the practice of most other countries by providing that the Export Credits Insurance Corporation be exempt from income tax. (While the Corporation's gross premium income in 1961 was $744,000, its income tax for that year was $740,000). This would permit the entire excess of premium income over operating expenses and net claims paid to be applied to a substantial reduction of premium rates, while net income from investments could be used to reinforce the Corporation's underwriting reserve."

I can understand, in view of the fact the government is providing the money on which you are making your investment income, there is a good reason for an income tax, at least up to this investment

MR. THOMAS: Whereas we are constant. We have gone below 85 per cent in some instances where, and obiously where, the exporter has made a substantial profit. We have gone as low as 60 per cent.

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suggestion:

- "It is recommended that the Government should follow the practice of most other countries by providing that the Export Credits Insurance Corporation be exempt from income tax. (Until the Corporation's gross premium income in 1961 was $4,665,000. the income tax for that year was $1,243,000). This would permit the entire excess of premium income over operating expenses and net claims paid to be applied to a substantial reduction of premium rates, until net income from insurance could be used to reinforce the Corporation's

I can understand, in view of the fact the government is providing the money on which pay the premium your insurance income, there is a good reason for an income tax, at least if to this insurance

income level. The last couple of years it has been running in excess of investment income. There must be some comment you have to make about this, other than the one that I have just made, which is rather obvious?

MR. AITKEN: Those words are music to my ears. I would be delighted were E.C.I.C. not subject to income tax. I think it has a very bad public relations effect. We are affected by the fact that exporters, even if you explain to them that while the tax we pay does not exceed the interest we earn on our donated capital -- because the government does not get any return on capital, I think not improperly the government can argue the income tax which is levied against us is a small return on the capital made available for our backing. But I think it has a bad public relations effect on exporters. We have to pay income tax, and they say, if we did not have to pay that our premiums would be reduced. In my view this would not necessarily be so, because we have been going since 1945 on this basis that this interest is in the nature of a guarantee fund and the premiums we charge, we say, will meet the claims we make.

I would be more than happy were the Act amended. It would require an amendment to the Financial Administration or Income Tax Act. I think it would be proper to be exempted from paying income tax because the theory behind it, my understanding is, is because those organizations which operate on such a basis pay tax, so they can be compared to those

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I would be more than happy were the act amended. It would require an amendment to the Financial Institutions or Income Tax Act. I think it would be proper to be exempted from paying income tax because the theory behind it, my understanding is, is because those organizations work towards on some a basis pay tax, so that can be computed to those

in similar fields of endeavour. It is only by the means of a government entity that you can get export credits insurance because in all countries the entities handling that insurance are government-owned or act on behalf of the government in respect of their export credit insurance, and they pay no taxes. We are the only entity in the world paying income tax.

COMMISSIONER BROWN: Say, for the sake of our discussion, your setup was changed around and the $15 million was returned to the government, and you operated on just an advance for your current operations -- without this $15 million guarantee in the background -- and you operated just on premium income and without income tax, would not the net result be much the same, and yet public relations would be improved?

MR. AITKEN: Yes, they would, I think, but the exporter who insures with us, and particularly in the case of large outstandings, wants to be sure we have the resources to pay him; and if we have to go and borrow money from the conolidated revenue fund to pay his losses he would not be as happy as he is now, because he knows we have $15 million out of which we can pay his losses.

COMMISSIONER BROWN: Alternatively, say this was merely on deposit with the Bank of Canada, without interest?

MR. AITKEN: Yes, that would be one way of handling it. I would like to have the capital

in similar fields of endeavour. It is only by the means of a government entity that you can get the capital needed under insurance basis in all countries the entitled hospitals that I mentioned and governments owned or not on behalf of the government in respect of their sound credit institutions, and that you can insure. We are the only country in the world having income tax.

CHAIRMAN HAGUE: Now, for the sake of our discussion, your selling was changed and the $45 million was returned to the government and your overhead be just as varied for your current operations -- without this $45 million insurance to the underground -- and you already had on premium income and without income tax, would not this out result be upon one side, and you borrow, Labour would be lowered?

MR. ALTMEYER: Yes, very much, I think. But the export-import banks function with us, and guaranteed, in the case of long outstandings, wants to -- have to go and borrow money from the countries because we have to pay into Europe and if we insure that to pay into Europe we would not be as willing to do so now, because in event we have $15 million out of which we can pay its losses.

CHAIRMAN HAGUE: Alternatively, as this was merely a deposit with the Bank of Canada;

MR. ALTMEYER: Yes that would be one way of handling it. I would like to have the capital

and the interest on the capital and no income tax, to continue to increase our guarantee fund.

COMMISSIONER BROWN: I think we understand that.

COMMISSIONER LEMAN: The exporter is quite happy. What he is paying you in premiums is deductible for tax purposes?

MR. AITKEN: Yes, that is an expense of doing business for him.

COMMISSIONER BROWN: How do your rates compare with the rates of other countries? Have there been any complaints about that?

MR. AITKEN: No.

COMMISSIONER BROWN: The fact there are not any complaints indicates your rates are reasonable?

MR. AITKEN: We think they are. We have meetings and discussions with the other export credit insurance corporations on the rates. It may happen, in a certain country, that because of that country's relationship vis-a-vis Canada, that our rates might be higher on a particular market than, say, that of the United Kingdom. For instance, the U.K. has extensive interests in Kuwait, and they might consider the risk there of non-transfer and non-payment was absolutely negligible; whereas for us it may be sterling rather than a U.S. dollar matter, and we might consider our risk a little greater and the rate would thus be higher. Alternatively, the reverse might be the case, and the risk of non-payment

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COMMISSIONER ROWE: I think we [illegible]

COMMISSIONER LAMONT: The economics is quite
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MR. ATKEN: Yes, that is an expense of
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COMMISSIONER ROWE: How do your rates
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[illegible]

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on a particular market share, say, that of the
United Kingdom. For instance, the U.K. has collapsed
insurance in Kuwait, and they might consider the
risk there of non-transfer and non-payment to
sometimes negligible; whereas for us it may be
sterling poor than a U.S. dollar market, and we
might consider our risk a little greater and the
rate would thus be higher. Alternatively, we
reserve might be the case, and the risk of non-payment

by that country might be higher for her than for us. So, the rates do vary, to that extent, among countries, but we think, by and large, our rates are comparative and not out of line with the others.

COMMISSIONER MACKINTOSH: You have full knowledge of the rates charged by other countries?

MR. AITKEN: Yes.

COMMISSIONER MACKINTOSH: And you exchange this information?

MR. AITKEN: Not on a tariff schedule basis. We have not a published tariff. We cannot publish our rate because if we were to say for country"A"we charge "X" and for country "B" "3X" you would have the ambassador of country "B" up to see the Prime Minister the next day.

At our Berne union meetings we do discuss rates, and as a result of that are satisfied that our rates are comparable and not out of line with those charged by other people in the same line of business.

MR. THOMAS: We carried out a survey about two years ago of our rate by countries and terms with the British rates, and more than 50 per cent of the countries were on an identical basis. The U.K. rate was exactly the same as ours, and the others did vary up and down -- in other words, they were higher in some cases than we were, and they were lower in some than we were -- but the 50 per cent, we thought, was a pretty good indication of keeping our rates fairly well in line with the British.

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COMMISSIONER MACDONALD: You have full knowledge of the rates charged by other countries?

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MR. HOWARD: We received out a few years ago two years ago of our mate by countries and terms with the British rates, and more than 90 per cent of the comparisons were on an identical basis. The U.K. rate was exactly the same as ours, and the others did vary up and down -- in other words, they were higher in some cases than we were, and the were lower in some than we were -- but (the 10 per cent, we should, was a pretty good indication of keeping our rates fairly well in line with the British,

COMMISSIONER BROWN: There is another point as regards long-term financing procedures:

"With regard to long-term financing procedures, the present system calling for the issue of promissory notes by the foreign buyer to the Canadian exporter, the guarantee of the notes by Export Credits Insurance Corporation and then their subsequent sale by the exporter appears to be somewhat cumbersome."

MR. AITKEN: I would agree with that.

COMMISSIONER BROWN: Have you any suggestion as to the way it might be dealt with?

MR. TAYLOR: I might give you a slight background on this point. Section 21A, under which we operate the long-term financing, existed prior to our entering into the operation of long-term financing. It was created some two years prior to that, really, with the basic intent of affording 100 per cent guarantee to exporters under medium-term business, but it was 100 per cent guarantee to the lender after the delivery had been made. This is why the emphasis in that section on the guarantee at that time was a main asset of the section. The main intent was that we would give 100 per cent guarantee to the lender, to encourage the availability of capital in support of this type of transaction.

When the actual operation on long-term financing was undertaken, to avoid going through, without any background of experience, especially,

COMMISSIONER BROWN: There is another point as regards long-term financing procedures:

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MR. ALTKEN: I would agree with that.

COMMISSIONER BROWN: Have you any suggestion as to the way it might be dealt with?

MR. TAYLOR: I might give you a slight background on this point. Section 21A, under which we operate the long-term financing, existed prior to our entering into the operation of long-term financing. It was enacted some two years prior to that, really, with the same intent of affording 100 per cent guarantee to exporters under medium-term business, but it was 100 per cent guarantee to the lender after the delivery had been made. That is why the emphasis in that section on no recourse at that time was a main asset of the section. The main intent was that we would give 100 per cent guarantee to the lender, to encourage the availability of capital in support of this type of transaction.

When the second operation on long-term financing was undertaken, to avoid going through without any background of experience, especially,

and to avoid the time-consuming process of setting up completely new legislation, it was decided it was possible to operate long-term financing schemes under conditions as they then existed. So, we began operations with legislation which was not designed for the purpose to which it was applied. As the legislation is written it contains this requirement that we must guarantee instruments and only subsequent to guaranteeing may we then purchase. The purchase of the promissory note is the real emphasis. We are controlled by the fact that we have first to guarantee. This results in the necessity of a note being given by the buyer to the exporter. We can't have the note made out directly to us, if we first have to guarantee it. We cannot guarantee to ourselves for the purpose of purchasing. This leads to this round-about method.

Actually, a fairly simple amendment, the elimination of the guarantee feature in the legislation which now exists, this would eliminate this aspect that is objected to by the exporters and which, in administering it, we find fairly cumbersome too.

COMMISSIONER BROWN: You are prepared to make such a recommendation? I am wondering why you have not recommended it to us if it apparently is in everybody's interest?

MR. AITKEN: It is rather a matter of government policy to change legislation.

COMMISSIONER MACKINTOSH: You would rather we recommend it to the government?

and to avoid the time-consuming process of setting up completely new legislation, it was decided it was possible to operate long-term financing schemes under conditions as they then existed. So, we began operations with legislation which was not designed for the purpose to watch it was applied. As the legislation is written it contains this requirement that we must guarantee instruments and only subsequent to guarantees, may we then purchase. The purchase of the promissory note is the real emphasis. We are controlled by the fact that we have first to guarantee. This results in the necessity of a note being given by the buyer to the exporter. We can't have the loans made out directly to us. If we first have to guarantee it. We cannot guarantee to ourselves for the purpose of purchasing. This leads to this round-about method.

Normally, a fairly simple amendment, the elimination of the guarantee feature in the legislation under new state's, this would eliminate this aspect that is objected to by the exporters and which, in administering it, we find fairly cumbersome too.

COMMISSIONER BROWN: You are prepared to make such a recommendation? I am wondering why you have not recommended it to us if it appropriately is in every body's interest?

MR. AITKEN: It is rather a matter of government policy to change legislation.

COMMISSIONER MACKINNON: You would rather we recommend it to the government?

MR. AITKEN: I see.

MR. THOMAS: I think the answer really is that we are still in the process of learning a lot about this long-term financing, and we are treading time up to a point, before any strong recommendations are made for a change in the legislation.

MR. AITKEN: It appears to be advisable to make some change. We are not quite clear yet, in our own minds, as to exactly what that change should be. We have had a year's experience in long-term financing, and it is evident that this method has its cumbersome details. It would be helpful to make some change, but we have not yet made up our minds what it should be. We have it under active consideration.

COMMISSIONER BROWN: You would like to see some change made, though you are not quite sure of the details?

MR. AITKEN: Yes, and that is why our brief has not made any recommendation on that point, because if we make a suggestion we feel we should say what the solution should be, rather than just mention the problem.

COMMISSIONER LEMAN: Perhaps there is some indication in your brief and in the attachments, but on which I was not quite able to get the answer on this point. In the one to five-year medium-term credit, what has happened, what have you accomplished to date in practical terms?

MR. AITKEN: In volume of business?

MR. ALTMAN: I see.

MR. THOMAS: I think the answer really is that we are still in the process of learning a lot about this long-term financing, and we are trying to come up to a point, before any strong recommendation is made for a change in the legislation.

MR. ALTMAN: It appears to be difficult to make some changes. We are not quite clear yet in our own minds, as to exactly what they should be. We have had a really explorative long-term financing, and it is awfully clear that the method has its complexities certain. It would be helpful to make some changes, but we have not yet made up our minds what it should be. We have it under active consideration.

COMMISSIONER TYSON: You would like to see some changes made, though you are not quite sure of the details?

MR. ALTMAN: Yes, and that is why our Board has not made any recommendation on that point, because if we make a suggestion we tend to avoid any that the solution should be, rather than just mention the problem.

COMMISSIONER LYMAN: Perhaps none of the indication in your brief and in the attachments, but on which I was not quite able to get the answer to this point. In the one to five-year financing, what has happened, what have you accomplished as date to practical terms?

MR. ALTMAN: In terms of business?

COMMISSIONER LEMAN: Yes, in the way of increasing the number you insure? You said this was going to help you?

MR. AITKEN: Yes.

COMMISSIONER LEMAN: How long has it been going on, and how far has it got to date?

MR. AITKEN: We have, since our inception, been prepared to insure capital goods sold on medium-term credit -- which is, roughly, one to five years. Over that period the Canadian chartered banks have almost invariably, in our experience, been prepared to provide financing for insured sales. However, from time to time, particularly in the era of so-called tight money, the exporters complained or alleged that financing was not readily available to them through their banking sources, through the chartered banks, and, accordingly, about a year or so ago, April, 1961, the chartered banks took over the charter of the Export Finance Corporation of Canada Limited, and that entity, which provides a new and separate source of medium-term financing, has been ready, willing and able to put up funds rapidly for any business which we will insure. They are more than anxious to put up funds. Their only complaint to date is that there is not sufficient for them to make full utilization of their resources.

COMMISSIONER LEMAN: You have no idea as to what the cause of this slow start is?

MR. AITKEN: Our insured medium-term business is increasing, but it is not something that is a continuing

COMMISSIONER LUMAN: Yes. In the way of increasing the number you have? You said this was going to help you?

MR. AITKEN: Yes.

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COMMISSIONER LUMAN: You have to look a little increased, but it is not enough. Is a certain
to what the cause of this slow terms is?

MR. AITKEN: One is a

such as
thing,/the export trade in consumer goods. It is necessarily spotty. Only capital goods exporters sell on medium-term credit. It is not the type of business that goes on a week to week basis. It may take anywhere from six months to three years for an exporter to negotiate a large contract for the sale of capital equipment to a foreign buyer. It is only when he succeeds that we are asked to provide the insurance. We constantly have commitments outstanding, upward of $100 million of prospective capital goods business. Only one per cent of that may result in actual business, but we have commitments on our books in excess of $100 million to assist exporters in seeking business abroad.

MR. THOMAS: This medium-term business is subjected to very heavy international competition, and it is very difficult.

COMMISSIONER LEMAN: From the insurance standpoint, is that business also subject to the rule about coverage in all markets?

MR. AITKEN: We insure on a specific basis, an individual policy to cover the particular contract of sale. In most cases exporters, however, who are capital equipment manufacturers, if they do business abroad on credit, they want to insure.

COMMISSIONER LEMAN: You said this was a sector of the business which is subject to very intense international competition?

MR. AITKEN: Yes.

COMMISSIONER LEMAN: Then I would ask you a

Mark Jackson

Jackson's dream stems in no minor degree, it is necessarily apparent. Only capital goods expenditures of business that goes on a year to year basis. Only large surpluses from new ventures to those would for an exposure to negligible x long-term growth for the sale of capital equipment to a foreign power. It is only when he succeeds that he is asked to provide the insurance. We therefore have counter-cyclical, upward of $100 million of promotional expenses goods business. Only one per cent of [illegible] result in actual business, but we buy, consequently our boats in excess of four oil [illegible] executives to seeking business abroad.

DR. THOMAS: [illegible]

to multiplied to very heavy promotional competition, and it is very difficult.

[illegible] from the insurance standpoint, is that business goes to subject to the free flow of [illegible]

MR. ANDERSON: [illegible] to [illegible] case. to [illegible] policy to cover the political [illegible] of sale. In most cases [illegible] are capital equipment [illegible], it may do continues abroad on credit, they must [illegible].

[illegible] only real [illegible] a source of the overseas which [illegible] to very [illegible] insurance [illegible]

[illegible]

CHAIRMAN [illegible] Then I would say [illegible]

tough one: do you think the recent improvement in Canada's exchange rate has had any effect? Can you see any signs, yet, of any improvement?

MR. AITKEN: We think it has been of tremendous importance, of inestimable value to the exporter. The exporters we talk to are increasingly encouraged by the fact that they are today competitive whereas two years ago they were not. Today they are competitive price-wise in many fields in the heavy equipment manufacturing.

COMMISSIONER MACKINTOSH: Is there evidence of their taking advantage of this situation?

MR. AITKEN: Very definitely.

COMMISSIONER LEMAN: I would like to ask you another question. You touched on it before a little bit, but I would like to go a little further into it. Regarding your sources of information, you said you have talked to the other export credit outfits that operate in the world, and that you have exchanged information with them. What other good sources of information do you use?

MR. AITKEN: We think that we have had a fairly successful operation over the past 17 years, and we attribute a great deal of that success to the tremendous assistance we have had from the Canadian Trade Commissioners' Service. They are outstanding chaps who do a first-class job, and we rely on them, to a great extent, to keep us posted on economic conditions in their countries. The regulations with regard to import licensing, foreign exchange

permits, etc., information with regard to credit terms, credit information on buyers, competition from other countries -- these are the types of information they provide us with. Frequently an exporter will allege, for example, that Germany is quoting on a project and is granting terms which , in our experience, are beyond those usual for such a sale, and we ask the Commissioner to check into it for us, and he is frequently able to supply us with chapter and verse.

COMMISSIONER LEMAN: Do you have a lot of direct relations with foreign banks in order to get information?

MR. AITKEN: No, we deal with the Canadian chartered banks, and go to them for information on foreign buyers.

MR. THOMAS: But we do have considerable sources of economic information, a lot of which does come from foreign banks -- American banks, the banks in London and in South America, and so on.

COMMISSIONER LEMAN: Is this mostly a burden strictly on the staff? What about this advisory board that you described? Can they help you in this sense at all?

MR. AITKEN: The Advisory Council was set up and it operates as the act says. It advises the board of directors on the administration of the corporation. We have meetings at which the Advisory Council reviews our entire operation -- our past experience, our present position and future prospects. The act has been amended several times during our seventeen years of existence, each time as a result of a specific recommendation of the Advisory Council, but the Advisory Council is not used as a source of credit information. Dr. Taylor, since he has assumed his responsibility as head of the export finance division, was our chief economist and maintained very close relationships with such institutions as the International Bank of Reconstruction and Development, the International Monetary Fund, and the Export-Import Bank. We are thus

provided with a first-class source of information in our consideration of economic and payment conditions in the various countries.

COMMISSIONER LEMAN: You do not consider yourself a source of information for those who do not insure with you?

MR. AITKEN: No, we are not a credit bureau.

MR. THOMAS: We have no legislative authority to do that.

MR. AITKEN: I will tell you a funny story. There was one exporter -- the president of that company is probably well known to you; actually he is no longer president of that company but president of another. He used to come in and ask us to insure a prospective sale, and when we were willing to insure he went ahead and did the business without insurance, but when we were not willing to insure he did not do the business. In any event, Canada got some of the business. We think there has probably been just as much business done with our initial encouragement that does not appear on our books as the business done where we have insured.

In many cases an exporter comes to us for a commitment to provide insurance in the event that he is successful in making a particular sale on credit terms that would require insurance backing. In such a case we consider all the aspects, and if we are prepared to take it we give him a commitment which is good for sixty or ninety days, and which can be renewed. Then the exporter goes out and negotiates with the buyer and, lo and behold, the buyer is prepared to pay

provided with a "just-plain" sort of information in
our consideration of economic and rayment conditions
in the various countries.

CHAIRMAN [illegible]: Can do not conceive
yourself a source of information for those who do not
agree with you?

MR. ALDRICH: No, we are not a credit agency.

MR. [illegible]: We have no constructive suggestion
to do this.

MR. PECK: I will tell you a funny story.
There was one executive -- the president of what company
is probably well known to you; counseling me in an opera
president of that company but president of another. He
went to come in and ask us to insure a proposition,
and when we were willing to insure he went ahead and did
business without \ not when we were not willing to insure
we did not do the business. In any event, there got so
of the business. We think quite possibly your
just as much business once with our initial precaution-
ary that does not appear on our books as the business
done where we have insured.

In many cases an explanation comes in for
a countenance to provide insurance \ the event must be
in success\ in making a particular sale on credit
terms that would negate insurance bonding. In short a
case we considered all the success, and if it is more
trained to make it we give him a commitment which it
used for many of whom very, and which are covered.
Then the executive goes out and negotiates also the
order and, in any event, this is [illegible] to pay

cash. However, that exporter has been encouraged to go and talk with the buyer.

MR. TAYLOR: Another aspect which is worthy of comment is with respect to, shall we say, many South American countries because it is their habit to get into foreign exchange difficulties. An exporter is likely to get a little bit panicky when a foreign exchange crisis develops in a country, and he will come up to see us immediately to find out what our attitude is. He will want to know if we are withdrawing cover, or if we are curtailing in any way. Exporters really pattern their trade policy in such a country, and their continuing export policy there, on the reaction they get from us.

In many markets such as Brazil and Colombia, where they had a complete exchange blockage, which went on for a year to eighteen months, the Export Credits Insurance Corporation, because of its policy of continuing coverage, granted on more selective basis did continue to provide coverage, and did maintain Canadian exporters in these markets where otherwise they would have ceased operations entirely.

COMMISSIONER LEMAN: The answer is that indirectly you end up by being a source of information for exporters.

MR. AITKEN: Yes.

COMMISSIONER LEMAN: When we reviewed the various obstacles or complaints that particular customers or prospective customers had voiced, there was no mention of the time element of doing business, especially

in this medium term field. Have there been any complaints about this type of business, it being on your own admission extremely competitive -- a lot of it being on a bid basis? How do you meet that? Is that fairly well solved as a problem? Is this problem of exporters coming to you and making sure they can get the insurance before they put in their bid fairly well solved? Can you describe how this works, and how it has developed?

MR. AITKEN: As a result of our having done business for seventeen years, exporters of capital equipment who might wish to make use of our services are daily, weekly and monthly becoming better informed of our method of operation, and of the information we require in order to be able to assess a risk. While frequently an exporter wants an answer yesterday, we are often able to give him an answer tomorrow.

Our working relationships with capital equipment manufacturers in the medium /term field is, I think, excellent, and the exporter appreciates that in order to give a decision we have to have as complete information as possible. Provided an exporter can give us all we need to know with regard to a particular transaction we can, as a rule, depending upon the size of the order, give him a commitment in a relatively short time -- not infrequently, over the phone, and frequently within a very few days, and certainly if he has given us complete information we can give him a decision within a couple of weeks., because if a Board decision is required we hold Board meetings on an ad hoc basis, but at least once a month.

to this medium term field. Have there been any complaints about this type of business, it being on your own admission extremely competitive -- a lot of it going on a bid basis? How do you meet that? Is that fairly well solved as a problem? Is this problem of exporters coming to you and making sure they can get the insurance before they put in their bid fairly well solved? Can you describe how this works, and how it has developed?

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COMMISSIONER LEMAN: But does not correspondence result and also delay when you are not given the information you need and you ask the exporter to go back and find it out? He has perhaps to go to the country of destination to find out what you want to know, and that might result in a long delay.

MR.AITKEN: That does happen, but in our experience only with inexperienced exporters. Experienced exporters go into it themselves because they have 15 per cent of the risk, and they get all of the information they require which is also what we require. Occasionally, you will get a hair-brained request which involves you in protracted correspondence, and which may result in nothing, but the protracted correspondence may be occasioned by the fact that the prospective exporter is inexperienced. With the experienced exporter, we have no difficulties whatsoever.

MR. THOMAS: Percentagewise the number of deals which would come to us which would require this sort of correspondence, I would say, would be probably less than 5 per cent of the deals we have, because most of the people are experienced in the field. It is just the odd one who is not.

COMMISSIONER BROWN: On this question of prospective deals, do you sometimes have requests from two competing exporters?

MR. AITKEN: That can happen.

COMMISSIONER BROWN: This brings up a supplementary question -- I do not want to interrupt your train of thought Mr. Leman. If you give an exporter

COMMISSIONER LINAM: But does not a prospective result and also delay when you are not given the information you need and you ask the corporation to go back and find it once? He has perhaps to go to the country of destination to find out what you want to know, and that might result in a long delay.

MR. ADAMS: That does happen, but in our experience only with inexperienced exporters. Experienced exporters go into it themselves because they have 15 per cent of the risk, and they get all of the information they require. Secondly, you will get a back-dated request which involves you in protracted correspondence, and which may result in nothing. But the production correspondence may be contracted by the fact that the prospective exporter is inexperienced. With the experienced exporter, we have no difficulties whatsoever.

Mrs. JONES: Irrespective the number of deals which would come to be taken would require this sort of correspondence, I would say, would be probably less than 5 per cent of the deals we have, because most of the people are experienced in the field. It is just the odd one who is not.

COMMISSIONER LINAM: In this question of prospective deals, do you sometimes find requests from the countries; exporters?

MR. ADAMS: Most can happen.

COMMISSIONER LINAM: While bringing it a supplementary question -- I do not want to interrupt your train of thought Mr. Adams. If you give an counter

a commitment on one of these medium term deals, is he commited to give you the business?

MR. AITKEN: No, absolutely not. An exporter can submit his application to us for a quotation and a commitment, but he does not incur any commitment whatsoever. He is just asking us what we would charge to insure him if he wants to insure.

COMMISSIONER BROWN: You do not charge him a stand-by fee?

MR. AITKEN: No. We have thought of that. In some countries they do it. In Belgium, for instance, they charge, I think, something like one-quarter of one per cent for a commitment, and then if the exporter gets the business and takes out a policy, they apply that payment against his premium, but they retain it if he does not get the business or if he does the business and does not insure.

But, we are here to help exporters to the maximum extent possible, and if the charging of a stand-by fee would, in any way, inhibit their coming to us for commitments or even advice then we would not be doing the complete job that we are trying to do.

COMMISSIONER LEMAN: Thank you for asking that question. It leads to my next question. You have not reached the limits of the business you can do without further legislation and, therefore, this is not an immediate problem, but you do say that the circumstances of world trade and our exchange rate, et cetera, may offer some promise of a good deal of increase.

a commitment on one of those matters, is he committed to give you the business?"

MR. ALLEN: No, absolutely not. An experienced and subtle application to us for a quotation and a commitment, but he does not insure any commitment whatsoever. He is just asking us what we would charge to insure him if he wants to insure.

COMMISSIONER BROWN: You do not charge him a stand-by fee?

MR. ALLEN: No. We have thought of that. In some countries they do it. In Belgium, for instance, they charge. I think, something like one-quarter of one per cent for a commitment, and then if the exporter gets the business and takes out a policy, they apply that payment against the premium, but then retain it if he does not get the business or if he does not do business and does not insure.

But, we are here to help exporters to obtain maximum cover possible, and if the wording of a stand-by fee would, in any way, inhibit their coming to us for cover--even to even advise them--we would not be doing the complete job that we are trying to do.

CHAIRMAN LAMBERT: Thank you for asking that question. It leads to my next question. Is there any record the Banks or the businessmen can produce of world trade and, therefore, the balance of payments, may often come because of a good deal of insurance.

MR. AITKEN: Yes.

COMMISSIONER LEMAN: You also explain to us that in this field of business the time between the giving of a commitment and the time when the business materializes can be quite long.

MR. AITKEN: Yes.

COMMISSIONER LEMAN: How will you cope with this from the point of view of the limits within which you can operate? Would you just go to the government and ask for leeway?

MR. AITKEN: No, we have never given commitments beyond the ceiling of our powers in the act. In the act we have an overall total of $700 million, of which $200 million can be handled by our Board of directors on its own responsibility. We can incur commitments, actual outstandings and commitments, up to an aggregate of $200 million under Section 14 of the act. Under Section 21 the government has the authority to authorize us to insure up to another $200 million, and then under Section 21 (a) we have $300 million for long-term financing.

My view is -- and George Hees has said this recently; we report to parliament through the Minister of Trade and Commerce -- that if any of these ceilings is ever pushed he will be only too delighted to go back to parliament to ask it to raise the ceiling.

COMMISSIONER LEMAN: But the straight relationship of commitments to actual business could become a problem, could it not?

MR. AITKEN: Yes, but you will recall that I

CHAIRMAN DIMAN: You also explain to us
what is this field of business the time between the
saving of a commitment and the time when the business
actually goes on can be quite long.

MR. ANDREW: Yes.

CHAIRMAN DIMAN: How will you come with
this from the point of view of the limits within which
you can operate? Would you just go to the government
and ask for leeway?

MR. ANDREW: No, we have never given
commitments beyond the ceiling if one person in the
pot. In both we have an overall total of $100 million,
of which $300 million can be handled by our Board of
directors on its own responsibility. We can issue
commitments, without notice to Ottawa and commitments, up
to an aggregate of $300 million under Section 14 of
the act. Under Section 21 the government has the
authority to authorize us to increase up to another
$600 million, and then under Section 21 (a) we have
$900 million for long-term financing.

My view is -- and Cooper does have some
recent); we expect to participate through the Minister
of Trade and Commerce -- that if any of those ceilings
in any period we will be only too delighted to go back
to parliament to ask it to raise the ceiling.

Only of continuous to reduce business could leave a
problem, could it not?

MR. ANDREW: Yes, but you will recall that I

said we continually run about $100 million of commitments on our books all the time. Our actual liability under policies in force under Section 14 is about $70 million, so we have $130 million actual leeway. Our commitments of $100 million bring us up to about $170 million, so we still have a leeway of $30 million, including commitments.

Under Section 21 we also have $200 million of which today $168 million is committed.

THE CHAIRMAN: I understand what you said about your rates, namely, that your rates are comparable to similar British rates for comparable risks.

MR. AITKEN: Yes.

THE CHAIRMAN: Are the British rates you speak of the rates of private companies?

MR. AITKEN: No, the rates of the Export Guarantee Department.

THE CHAIRMAN: That is of Great Britain?

MR. AITKEN: Yes.

THE CHAIRMAN: That is a similar institution to yours?

MR. AITKEN: The only difference is that we are a Crown company, and they are a government department.

THE CHAIRMAN: They would pay no income tax?

MR. AITKEN: That is right.

THE CHAIRMAN: That is one of the things I would like to have cleared up. If your rates were comparable to those of companies of an ordinary kind then I could not understand why you should not pay income tax too. However, that clears it up. I think

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we still have a leeway of $30 million, Mr. Chairman.

Under Section 21 we also have
$200 million of which today $168 million is committed.

THE CHAIRMAN: I understand what you said
about your rates, namely, that your rates are considerable
to cover certain losses for considerable risks.

MR. ALEXEN: Yes.

THE CHAIRMAN: Are the British rates put
away at the rates of private companies?

MR. ALEXEN: No, the rates of the Export
Guarantee Department.

MRS CHAIRMAN: That is of Export Britain

MR. ALEXEN: Yes.

THE CHAIRMAN: That is a unique institution

MR. ALEXEN: The only difference is that we
are a private company, and they are a government department

THE CHAIRMAN: They would pay to insure your

MR. ALEXEN: That's right.

THE CHAIRMAN: Then it is of the things
I would like to have cleared up. If your rates were
comparable to those of companies or an ordinary kind
of a I could not understand why you should not get
income tax rec. However, rec close it on. I think

that is all I wanted to ask.

COMMISSIONER MACKINTOSH: Perhaps I can add a word or two on this point of paying income tax. I do not know who it was who proposed that Crown corporations should pay income tax ---

MR. AITKEN: I have a theory.

COMMISSIONER MACKINTOSH: It came, to a large extent, from the major industrialists of this country, but here is one corporation with which they wish to deal and they want to change their views.

COMMISSIONER HARROLD: I have one question to ask with respect to the exchange of information between other countries as to your insurance rates. That occurs quite often, and you are aware of the rates in other countries, but that just pertains to the rate and not to the deal itself.

MR. AITKEN: We do not have too much exchange of correspondence on goods sold on short-term credits, but we have quite a bit of correspondence on medium term credit transactions. An exporter who is working up some business in, say, Mexico, will come in to see us. We are prepared to give up to three years' credit, and he alleges that the Germans or the Italians for this particular transaction, when they are competing against him, will go up to four years. We will write to the Germans or the Italians and ask if this is true, and if they say it is then we will say, because we all operate on very much the same basis and follow the same principles, that we will go to four years. We would seek to find out in this

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COMMISSIONER MACKINNON: Perhaps I can add a word or two on this point of payday income tax. I do not know who it was who proposed that Crown corporations should pay income tax ---

MR. ALTMAN: I have a theory.

COMMISSIONER MACKINNON: It seems, to a large extent, from the major importance of this country, but here is one consideration with which they wish to deal and they want to change their views.

COMMISSIONER MACKINNON: I have one question to ask with respect to this exchange of information between other countries as to your insurance rates. That occurs quite often, and you are aware of the rates in other countries, but that just puts me to the rate and not to the deal itself.

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particular case if they have agreed to go to four years, and if we are satisfied with their reasons we will go to four years. Even if we were not satisfied with their reasons we might agree to back our exporter so that at least with respect to credit terms he can match the terms that his German or Italian competitor is offering.

COMMISSIONER HARROLD: When it comes to the different rates you have to charge for the different risks as between countries there is nothing in your financial statement that shows the appropriate rates?

MR. AITKEN: No.

COMMISSIONER HARROLD: At what time are those disclosed?

MR. AITKEN: Among ourselves, do you mean?

COMMISSIONER HARROLD: Yes.

MR. AITKEN: At our meetings, or in correspondence I would ask: What are you charging for such and such a deal", and they would say: "4.69 per cent," or whatever it is.

COMMISSIONER HARROLD: But are these rates disclosed during the current year in our own country. Do you disclose the different rates charged by different countries? You mentioned something about the ambassadors.

MR. AITKEN: No, we do not. The sophisticated importing communities, even in the developing countries, are fully aware of the existence of export credits insurance in the capital goods exporting countries, and they know by and large what their sellers -- the exporters -- are charged to

insure. We have had importers coming in to see us from Latin American countries and asking: "What do you mean by charging 4½ per cent for this risk when you know that in the United Kingdom they charge only 3 3/4 per cent?". Well, we do not let exporters tell the foreign buyer or the exporter's foreign agent that he has export credit insurance. In our view it is better for the exporter to deal with the buyer, and for the exporter to deal confidentially with us. The buyer should not know that the exporter has insurance, and for this reason; let us take a buyer in a particular country who buys from ten Canadian suppliers and who knows that one is insured. If he gets a little strapped for cash he will pay the other nine, but not pay the one who is insured because he will say: "That chap can claim from export credits." In our view it is better to maintain a confidential relationship between the exporter and the corporation. The exporter agrees in his application that he will not disclose the fact that he has a policy to anyone other than his banker. He is not supposed to discuss export credits insurance with the buyer or the foreign agent.

COMMISSIONER LEMAN: But from what you said earlier, it does get around.

MR. AITKEN: Yes, there is no question about that.

COMMISSIONER LEMAN: And if you have to raise the rates to a certain country, you may just happen to be out to lunch when somebody comes in to inquire.

MR. AITKEN: Yes, that is right.

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[illegible] American customers ask asking: "What do you mean
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for the exporter to deal with the buyer, and for the
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should not know that the exporter has insurance, and
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with the buyer or the foreign agent.

CHAIRMAN BROWN: But from what you
said earlier, it does not appear.

MR. ALTMAN: Yes, there is no question about
it.

CHAIRMAN BROWN: And if you have no insurance
the reason to a certain country, you may just refuse to
ever to trade when somebody comes in the [illegible].

MR. ALTMAN: Yes, that is right.

COMMISSIONER HARROLD: You have regard to nothing except the rate of the insurance on the credit?

MR. AITKEN: Yes, that is right.

COMMISSIONER HARROLD: You have nothing to do with the rest of the deal?

MR. AITKEN: No, nothing.

THE CHAIRMAN: Thank you very much, Mr. Aitken and gentlemen. This has been a very interesting discussion, and we are all very favourably impressed with the manner in which the Corporation's business has carried on.

MR. AITKEN: Thank you very much, sir, for having allowed us to present this brief.

THE CHAIRMAN: We shall now adjourn until 9.15 A.M. on Monday, September 17, when we shall hear the views of the Montreal and Toronto Stock Exchanges.

--- Adjournment.

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Royal Commission on Banking and Finance

Hearings held at

OTTAWA

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Toronto, Ontario

SUBMISSION

TO THE

ROYAL COMMISSION ON BANKING AND FINANCE

PRESENTED BY THE

CANADIAN METAL MINING ASSOCIATION

Canadian Metal Mining Association
Room 335
12 Richmond Street East
Toronto 1, Ontario

MAY 1962

SUBMISSION

TO THE

ROYAL COMMISSION ON BANKING AND FINANCE

PREPARED BY THE

CANADIAN METAL MINING ASSOCIATION

Canadian Metal Mining Association
Room 235
12 Richmond Street East
Toronto 1, Ontario

MAY 1962

Nethercut & Young
Toronto, Ontario

Royal Commission on Banking and Finance,

OTTAWA, Ontario.

Honourable Commissioners,

We welcome the opportunity of presenting to you this submission on behalf of the Canadian Metal Mining Association.

1. IDENTIFICATION

The Association is a national organization representing the great majority of operating mines in this country, including the major producers of base metals, gold, silver, uranium, iron ore and some industrial minerals, of which asbestos is the chief.

Attached to this brief is a list of our member companies and the names of our officers and directors.

2. SIZE OF INDUSTRY

Some indication of the size and importance of the mining industry in the economy of this country is given by the following figures as published by the Dominion Bureau of Statistics.

Value of Mineral Production of Canada, 1961

Metallics	$ 1,397,014,089
Non-metallics	210,250,683
Mineral fuels	643,425,160
Structural materials	323,092,906
Total	$ 2,573,782,838

From these figures it will be seen that the metallics proportion of Canada's mineral production, accounting between them for approximately $1.6 billion

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Structural materials	253,098,906

From these figures it will be seen that the Metallics proportion of Canada's mineral production accounting between them for approximately $1.6 billion

Nethercut & Young
Toronto, Ontario

of new wealth annually.

3. CONTENTS OF BRIEF

In this brief we wish to concentrate attention on four major topics:

(1) gold as a monetary metal and policy related thereto;

(2) the paramount importance of maintaining the Canadian dollar at a stable discount;

(3) the importance to the mining industry of various sources of finance, including capital from abroad, and

(4) the effect on financial reserves of current levels of taxation, federal and provincial.

Our views on each of these topics are set forth in the body of the submission.

They lead to the following conclusions and recommendations:

4. GOLD

(1) The gold mining industry in Canada is an important asset to our economy.

(2) In view of the renewed interest in gold and its role as the final medium of international exchange, it is appropriate and timely to examine the "gold question" in all its aspects.

(3) The Canadian Government might be well advised to build up its gold holdings.

(4) The gold mining industry should be supported and sustained as a valuable hedge against possibilities of recession.

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(4) The gold mining industry should be supported and sustained as a valuable hedge against possibility of recession.

5. CANADIAN DOLLAR DISCOUNT

(1) We commend the action taken in May be the Minister of Finance to peg the dollar at a considerable discount.

(2) This action is helpful to the gold mining industry directly by increasing the Mint price of gold, and to the mining industry in general, which has become a major segment of Canada's export trade.

(3) The pegged exchange rate assures a desirable element of stability to all industries which must export the bulk of their products.

(4) The pegged exchange rate puts this country into a more advantageous relationship with the United States and the International Monetary Fund.

(5) It is recommended that all feasible means be adopted to maintain a stable discount.

6. SOURCES OF FINANCE

(1) While the larger mining companies are able to finance their own exploration and development programs, access to outside sources of venture capital is necessary for the growth and welfare of the mining industry.

(2) We share and commend the stated policy of the Government of Canada to encourage Canadian financial participation in ownership of Canadian industry, including resource industries.

(3) We believe, however, that any steps taken in this direction should actively encourage Canadians to participate without discouraging

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(3) We believe, however, that any steps taken in this direction should actively encourage Canadians to participate without discouraging

needed capital from abroad.

(4) Capital requirements for large-scale mining operations are of a magnitude which makes it quite impracticable to rely on Canadian sources alone.

(5) Any regulations put into effect by the Government of Canada which tend to discourage foreign investment should be carefully reviewed and revised.

(6) Positive steps to encourage greater financial participation in resource developments by Canadian citizens, such as increased tax relief on dividends, might well be considered as part of a well-designed long-term program.

7. FINANCIAL RESERVES AND CURRENT LEVELS OF TAXATION

(1) Current levels of taxation, federal and provincial, are such as to leave inadequate financial reserves in the hands of corporations and individual citizens.

(2) Unbalanced federal budgets, massive deficits, substantial increases in federal spending, sharp increases in provincial taxation combine to aggravate a dangerous and difficult situation.

(3) Major social and industrial problems, such as unemployment and under-production, are clear evidence of an unsatisfactory rate of economic growth.

(4) Positive and powerful incentives to stimulate productive enterprise are needed to get the economy

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(6) Positive steps to encourage greater Canadian participation in resource developments by Canadian citizens, such as increased tax relief on dividends, might well be considered as part of a well designed long-term program.

CONCLUSION

(1) Current levels of taxation, federal and provincial, are such as to leave inadequate financial reserves in the hands of corporate and individual citizens.

business, small increases in federal spending, sharp increases in provincial taxation could be expensive deterrents and difficult situation.

(3) Major social and industrial problems, such as unemployment and under-production, are clear evidence of an unsatisfactory rate of economic

(4) Positive and powerful incentives to stimulate productive enterprise are needed to get the econ

advancing at a brisker pace.

(5) Constructive steps are desirable to make available to industry a larger share of the profits which it generates, so that it can operate at maximum effectiveness, increasing both production and employment opportunities.

(6) Much government spending is of a non-productive character and encourages dependence on social welfare benefits instead of the self-earned fruits of productive employment.

(7) Tax policy, more effectively co-ordinated between federal and provincial authorities, should be revised with a view to releasing to industrial corporations and to individual citizens a greater share of their revenues in order to stimulate productive enterprise.

.....

This concludes our summary of the considerations and recommendations which we wish to draw to the attention of the Royal Commission.

.....

We now proceed to set forth the reasons which have led us to these conclusions.

Nethercut & Young
Toronto, Ontario

8. GOLD

Canada is the second largest gold producer in the free world.*

Since the end of World War II Canadian gold production has been fairly steadily maintained at an annual output of about 4.5 million ounces, valued in round figures at $150 million.

Two factors have been mainly responsible for this stability of production, increased output of gold as a by-product of base metal mining operations and the assistance rendered by the federal government to "straight" gold producers, i.e., gold mines officially defined as mines the value of whose output is derived from gold to the extent of 70 per cent or more.

The Emergency Gold Mining Assistance Act first came into force in January 1948. It has been periodically renewed and remains in effect until the end of 1963. Of the 51 lode gold mines now operating in Canada 42 receive government assistance, which of recent years has averaged $10 million to $12 million a year.

Therefore not only the gold mining industry but the people of Canada also have a substantial stake in gold.

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* See chart on next page.

* FREE WORLD GOLD PRODUCTION

(in thousands of fine ounces)

Countries	1959	1960
Union of South Africa	20,065	21,386
Canada	4,483	4,602
United States	1,389	1,386
Australia	1,085	1,083
Ghana	913	893
Southern Rhodesia	567	563
Colombia	398	434
Philippines	403	408
Japan	328	331
Congo Republic [1]	338	300**
Mexico	314	299
Total listed	30,283	31,685
Other countries[2]	1,817	1,915
Estimated world total[2]	32,100	33,600**

[1] Formerly the Belgian Congo. [2] Excluding the U.S.S.R. ** Estimated.

Source: Bank for International Settlements, Thirty-first Annual Report, 1st April 1960 - 31st March 1961.

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Toronto, Ontario

9. GOLD AS A MONETARY METAL

Public interest shown in gold and in the role which gold plays as an international monetary metal is greater now than it has been for many years past. This interest has been stimulated by the drain of gold from the stocks held by the United States Treasury.

Before the outflow of gold from the United States began in 1958 the U.S. gold stock stood at $22.7 billion. It is now valued at $16.4 billion, less than in 1939. As the U.S. gold stock diminished, many qualified authorities regarded $17 billion as the critical point. The stock has now fallen well below that level.

Many observers believed that a crisis of this character and magnitude would force an increase in the gold price. However, it is clear, as we have had the opportunity of learning at first-hand from officials of the United States Treasury, that every effort will be made by the Government of the United States and the International Monetary Fund to maintain the established gold price.

While the question of an increase in the gold price is a matter on which there are conflicting opinions held by authorities of the greatest competence, we in the Canadian Metal Mining Association agree with the thesis, advocated by economists of distinction, that gold is being produced in insufficient quantities to play adequately the role which it is called upon to play as the sole and universally accepted medium of international exchange and in the final settlement of

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international payments.

Gold continues to provide the only practicable means for effecting final settlement of international accounts. The alternative of settling balances with foreign exchange involves accepting a promise of the debtor country rather than a portable asset, and hence lacks finality. As finality of settlement is till generally favoured, individual countries and international financial institutions alike continue to hold gold as a reserve against adverse movements in balances of payments. It is only as a regulator of domestic monetary policy that gold has lost its former role.

We would draw the attention of the members of the Royal Commission to the work of Dr. Robert Triffin, of Yale University. While we do not concur in the major proposals which he makes, we do believe that there is weight in his critical analysis of the causes of our current international financial discontents. He points out that because of the inadequacy of the quantity of gold available, national currencies, especially U.S. dollars and sterling, have to be used to supplement gold in the reserve funds of the nations of the free world. This means that these currencies are doing double duty as <u>national</u> currencies and as <u>international</u> currencies; and he believes that this is the root of many of the financial troubles which we have experienced since the end of the Second World War.

We see no way out of this dilemma except to take steps to enable gold to play a fuller role.

The amount of gold that can be produced at any time is strictly limited. The obvious way to enable gold to play more adequately the role required of it is to increase the gold price.

It is to be noted that of the $3.5 billion of gold newly mined in the free world during the past three years of record, only half has gone into official monetary reserves, so that the total of free world official reserves has risen by only 1.34 per cent per annum. Meanwhile the value of free world trade has been increasing very much more rapidly, namely, 7.11 per cent per annum for the same period, so that, without an adjustment in the gold price, gold is progressively less able to do the work required of it.

This critical situation will be aggravated as the volume of trade in the Western World continues to grow, as we may reasonably expect it to do, with the development of the European Common Market, and particularly if the President of the United States wins authority from Congress to implement the trade program which he has already announced.

10. GOLD PRICE

We are all familiar with the arguments usually advanced against raising the price of gold. We believe however, that there are more adequate counter-arguments, though it would be inappropriate to review these in detail in such a brief summary as we are now presenting. It is our belief that an increase in the gold price would render international trade freer, more flexible and larger in volume.

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It is to be noted that of the $93.5 billion of gold newly mined in the free world during the past three years of record, only half has gone into official monetary reserves, so that the total of free world official reserves has risen by only 1.3% per annum. Meanwhile the value of free world trade has been increasing very much more rapidly, nearly 7 1/2 per cent per annum for the same period, so that, without an adjustment in the gold price, gold is progressively less able to do the work required of it.

This contradictional situation will be aggravated as the volume of trade in the Western World continues to grow, as we may reasonably expect it to do, with the development of the European Common Market, and particularly if the President of the United States wins authority from Congress to implement the Kennedy program which he has already announced.

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11. CANADA'S GOLD RESERVES

In the current circumstances, especially in view of the strain under which the gold stocks of the United States have recently been placed, the possibility arises of a unilateral devaluation of the U.S. dollar.

Prudence suggests that Canada's foreign exchange reserves should now be kept very largely in gold. In fact, however, the proportion of our reserves held in gold shrank from 60 per cent at the end of 1957 to 46 per cent in June 1961. Since then that proportion has risen again to 60 per cent, partly through accumulation of gold but mostly on account of the shrinkage in total reserves. It is to be hoped that, as Canada's foreign exchange reserves are rebuilt, the proportion held in gold will not decline again below the 60 per cent level but rather will increase to the point where only necessary working balances would be kept in U.S. dollars. Gold should then comprise more than 80 per cent of Canadian reserves.

12. VALUE OF STRONG GOLD MINING INDUSTRY

There is another aspect of the gold mining industry in Canada which is worthy of note. In earlier years it was the search for gold which spear-headed exploration and led to the discovery of Canada's metal resources.

The development of a strong gold mining industry in this country, following the discovery of the mines of Timmins, Kirkland Lake, Northwestern Quebec and other areas, was one of our principal mainstays and

11. CANADA'S GOLD RESERVES

In the current circumstances, especially in view of the events under which the gold stocks of the United States have recently been placed, the possibility arises of a multilateral devaluation of the U.S. dollar.

Prudence suggests that Canada's foreign exchange reserves should now be kept very largely in gold. It does however, the proportion of our reserves held in gold shrunk from 90 p.c. each at the end of 1957 to 45 per cent in June 1961. Since then that proportion has risen again to 60 per cent, partly through accumulation of gold but mostly on account of the shrinkage in total reserves. It is to be hoped that, as Canada's foreign exchange receipts are rebuilt, the proportion held in gold will not decline again below the 60 per cent level but rather will increase to the point where only necessary working balances would be kept in U.S. dollars. Gold earns'o thing comprise more than 30 per cent of Canada's reserves.

12. VALUE OF NEWLY MINED GOLD TO THE WORLD

There is another aspect of the gold industry in Canada which is worthy of note. In earlier years it was the search for gold which spurred mineral exploration and led to the discovery of [illegible]

The development of a country's [illegible] industry in this country, following the discovery of the mines of Timmins, Kirkland Lake, Northwestern Ontario and other areas, was one of our principal main keys on

supports against the worst effects of the depression of the 1930's.

13. RECOMMENDATIONS

In view of the important part which gold production plays in the economy of Canada, we would urge that much closer attention be paid, and much greater consideration be given, to the importance of the gold question in all its aspects. We trust that the Royal Commission on Banking and Finance will have some recommendations to make to the Government of Canada concerning the policy which it should adopt regarding gold.

Further, in view of the factors mentioned above, the government would be well advised to build up its gold holdings. (At $35 (U.S.) per ounce gold is underpaid.

The gold mining industry should continue to be supported and sustained by all practicable means as it constitutes a valuable counterpoise against economic recession.

14. EXCHANGE RATE AT A STABLE DISCOUNT

The long-continued premium on the Canadian dollar proved a very severe handicap to both domestic industries in Canada and our export industries.

We strongly commend the steps taken by the Minister of Finance to restore the Canadian dollar to a reasonable level of discount vis-a-vis the United States dollar. Such an action was absolutely imperative if Canadian industry was to have the opportunity of competing on terms of anything like equality in world

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14. ECONOMIES FROM A LOWER DISCOUNT

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markets.

15. MINING EXPORTS AND INTERNATIONAL COMPETITION

In the last few years the mining industry has emerged as a very substantial, if not the single greatest, factor in Canada's export trade. With the return of prosperity to Western Europe we are aware of the possibilities of increasing demands for Canadian metals there, as elsewhere in the free world. We are also very much aware that Canada has no monopoly of mineral resources and that mineral developments are being undertaken with speed and skill in many other countries, including some usually described as "underdeveloped". It has become obvious in the last few years that international competition for markets is more intense than has ever previously been experienced. This means that every practicable means must be adopted to make Canadian products competitive with products produced in other countries without surrendering the high living standards which have been built up on the North American continent. This will be a feat not easy of achievement. It will be next to impossible if Canadian industry is not assured of a financial policy which makes a stable discount on the Canadian dollar a firm, important and continuing aim.

The ratio of exports to Canada's gross national product remains high, about 20 per cent, though it is not quite so high as it used to be. The boom in Canada in 1956-57 was associated in large measure with the growth in our exports of primary materials and capital investment undertaken in response

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to the expectation of continued high rates of growth of these exports. Conversely, the weakness in the Canadian economy since 1958 can be ascribed, not wholly, but in considerable part, to the failure of these exports to grow as rapidly as had been expected.

Metals, apart from gold, have constituted a major item of Canada's export trade. They have comprised an increasing proportion of total exports in every post-war year except one. Starting at 8 per cent in 1946, they rose to 22 per cent in 1960. Details of the composition of Canada's exports of the principal metallic minerals, in millions of dollars and as a percentage of the total commodity exports of Canada, for the years 1946 and 1960, are given in an accompanying table.

In view of the reasonably assured prospect of continued growth in Canada's mining industry, it is fair to assume that the part played by mineral products in Canada's export trade will increase rather than diminish. The realization of this prospect, however, will depend in no small measure on firm policy as regards the rate of exchange of the Canadian dollar.

Further, it may reasonably be anticipated that a stable discount on the Canadian dollar will encourage the growth not only of export industries but of domestic industries also, with beneficial effects on Canadian employment.

Nethercut & Young
Toronto, Ontario

16. SOURCES OF FINANCE

Of no less importance to the realization of continued growth and prosperity in Canada's mining industry is a financial policy which will not discourage the inflow of capital from outside this country.

We strongly approve of the objective, which the federal government has adopted as a primary plank in its program, namely, accelerated mineral development in Northern Canada, and in the Northwest Territories in particular. As we pointed out at the time, however, when advice from the industry was sought on this question, as embodied in the Canadian Mining Regulations, would not be effective. Rather, they would result in deterring the inflow of needed capital from the United States and from other countries, and in retarding rather than accelerating exploration and development activities.

This particularly applies to that section of the Regulations dealing with Canadian financial participation, whereby in order to qualify for a licence to operate a mine a company must either be 51 per cent beneficially owned by Canadian citizens or listed on a recognized Canadian stock exchange.

This Regulation is simply not acceptable to many companies which would otherwise expend large sums in mining exploration and development.

We have to report with regret that our discouraging forecast in this matter is being justified. Many millions of dollars which would otherwise have been spent on mineral exploration in the Northwest

SOURCE OF FINANCE

Territories have, because of this objectionable requirement, either been diverted elsewhere or not spent at all. While the experience of a single year may not be too conclusive, it is strongly indicated that the aim of the Government of Canada to encourage and accelerate the development of northern mineral resources will not be achieved until these Regulations are amended.

17. MAGNITUDE OF CAPITAL RESOURCES NEEDED

In general, while it is true that Canadian mining companies are generating from their own resources more adequate reserves of funds for the purpose of finding new mines to replace those that become depleted, it is also true, especially in certain segments of the mining industry, such as iron ore, that the expenditures required, not only for exploration but for development, are of such magnitude that Canadian funds are simply not available. We would cite as examples the $250 million odd required to bring in the New Quebec-Labrador properties of Iron Ore Company of Canada and the $300 million expenditure required to bring into production the iron ore properties of Quebec Cartier Mining Company.

18. STIMULANTS TO INVESTMENT

In the face of these circumstances, it can hardly be considered in the national interest to raise obstacles to the inflow of capital from abroad. Certainly we think it a matter of the greatest importance that any steps taken to reach the desirable objective of broader Canadian financial participation in

Tomlinsons have, because of this unacceptable requirement, either been diverted elsewhere or not acted at all. While the experience of a single year may not be too conclusive, it is strongly indicative that the aim of the Government of Canada to encourage and accelerate the development of northern mineral resources will not be achieved until these deficiencies are remedied.

In general, while it is true that Canadian mining companies are operating from cash resources more adequate reserves or funds for the purpose of finding new mines to replace those that become depleted it is also true especially in respect of the mining and equipment such as iron ore that the expenditures required, not only for exploration and for development, are of such magnitude that Canadian firms are simply not available. We would point to examples like Steep Rock Iron Mines Limited, New Quebec Iron Properties of Labrador Limited, Quebec Iron Corporation and Iron Ore Company of Canada and the $300 million expenditure required to bring into production the Iron Ore properties of

12. [illegible]

In the face of these circumstances, it can hardly be considered in the best interest to raise obstacles in the form of capital cost proposal. Certainly we submit a policy of the Government [illegible] importance than any steps taken to reach the [illegible] objective of [illegible] foreign financial [illegible]

Canadian operations, whether industrial or mining, should not be done in such a way as to deter needed capital from outside our borders.

As it is agreed that greater financial participation by Canadian citizens in resource developments is an objective to be encouraged, positive steps to stimulate such participation are needed. Among such steps which might well be considered are a reduction in personal income tax, so that the ordinary citizen may retain control of a greater share of his earnings, and further stages of tax-relief on dividends derived from mining operations.

19. SOME FINANCIAL CONSEQUENCES OF TAX POLICIES

While this Royal Commission may not be directly concerned with tax policies, federal and provincial, it would be improper to ignore some of the financial consequences of tax policies now in effect.

We stress the simple point, which has been reiterated many times lately by prominent and responsible business men, that the present rates of corporate income tax, coupled with other taxes levied on business profits, leave in the hands of management altogether too small a margin of reserve funds to expend their enterprises with the vigour and at the speed needed to accelerate the pace of Canada's economic growth.

During a period of massive deficits in the Federal Budget, provincial governments are seeking new means of enlarging their revenues by levying higher taxes. Most of the weight of this increased

taxation falls upon business and industry, cutting heavily into those financial resources which could be more profitably and beneficially used to expand industrial operations. Levels of taxation in this country may not yet have reached the point of producing diminishing returns, but they are certainly at the point of impeding rather than encouraging business enterprise.

To illustrate the extent and recent growth of the tax burden current in this country, Mr. J. K. Macdonald, President of Confederation Life Association, recently noted the following facts and figures.

While Canada raises 63 per cent of its revenue from direct taxes on income and wealth, Italy raises only 26 per cent of its revenue by this means, Norway 27 per cent, Switzerland and France 31 per cent, Belgium 39 per cent and Britain 55 per cent.

Federal government spending rose about 35 per cent in the five years ending March 31st, 1961, while the per capita gross national product, adjusted for price changes, fell 3 per cent.

In the five years ending in 1960, Ontario increased its spending 90 per cent and Quebec 86 per cent.

These are disconcerting figures which emphasize the fact that current levels of taxation are a strong deterrent to the accumulation of those savings and financial resources badly needed for improved and expanded production.

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These are disconcerting figures which emphasize the fact that current levels of taxation are a strong deterrent to the accumulation of those savings and financial resources badly needed for improved and expanded production.

It is our conviction that governments, federal and provincial, should moderate and reverse their course in taxation policy.

Much government spending is of a non-productive character and encourages dependence on social benefits instead of reliance on earnings generated by personal effort.

Reduced taxation would leave under the control of corporations and individual citizens a larger share of such earnings. These, applied to productive purposes, would accelerate the rate of economic growth, and act as a positive and constructive step towards the solution of the unemployment problem.

Government revenues also would benefit from the higher levels of prosperity which would ensue.

If such a result is to be achieved, it will be necessary to co-ordinate more effectively the tax policies of the federal and provincial governments.

Unless this is done, there seems little likelihood of releasing to individual citizens and to corporations that greater share of their own earnings which is required for the stimulus of productive enterprise and an accelerated rate of economic growth.

Respectfully submitted

on behalf of the

CANADIAN METAL MINING ASSOCIATION

E. B. Gillanders
President

V. C. Wansbrough
Vice-President and Managing Direc

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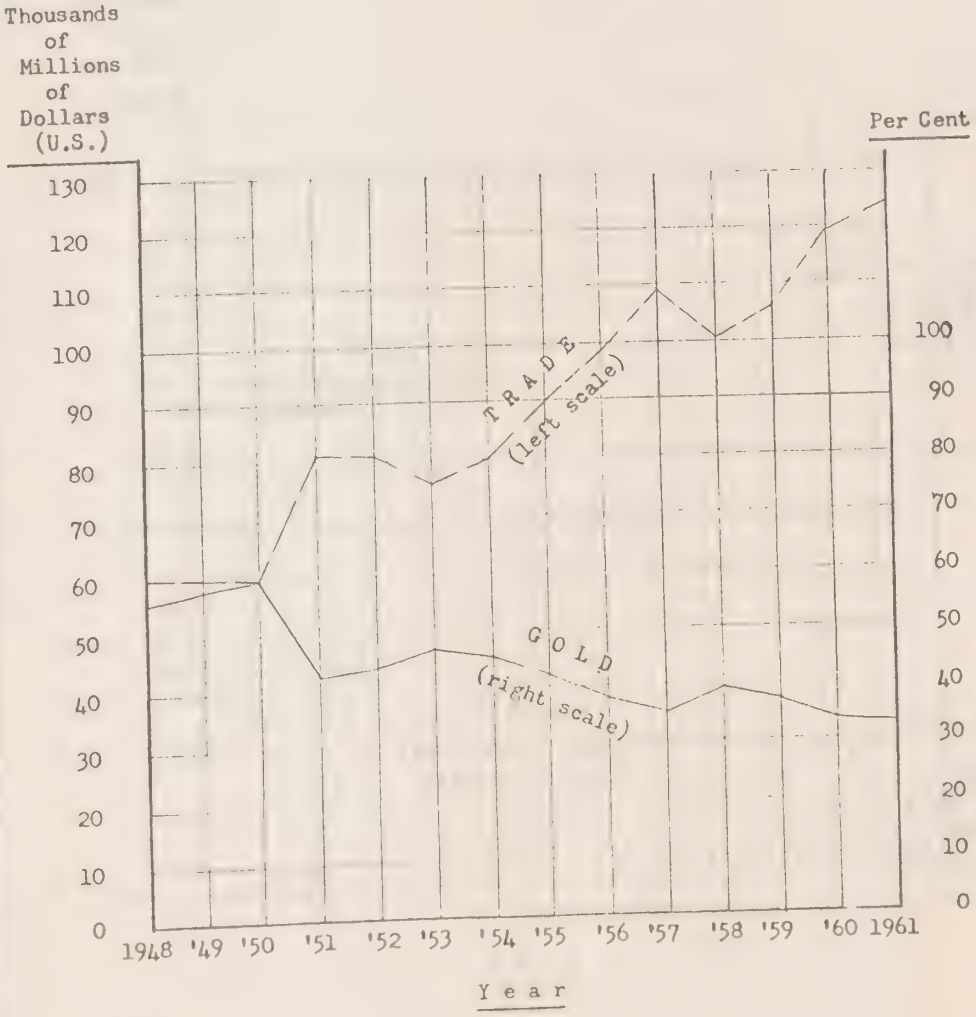
Nethercut & Young
Toronto, Ontario

Appendix 1

Graph Showing

(DURING THE PERIOD 1948 - 1961)

1. TOTAL FREE WORLD TRADE
2. TOTAL FREE WORLD OFFICIAL GOLD HOLDINGS AS A PERCENTAGE OF TOTAL FREE WORLD TRADE



Calculated from data in INTERNATIONAL FINANCIAL STATISTICS prepared by the Statistics Section, International Monetary Fund.

C.M.M.A.
May 1962

TRANSCRIPTION BY XRA MEMBER

Appendix 2

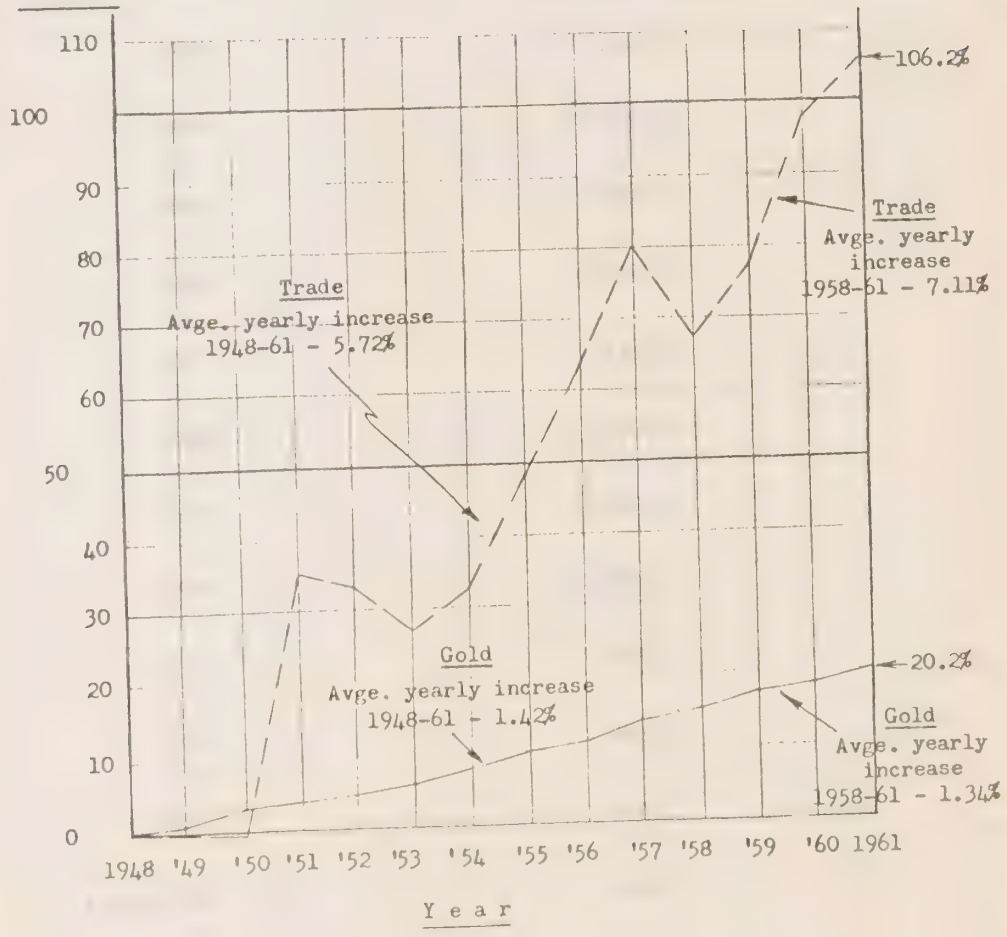
Graph Showing

PER CENT INCREASE OVER 1948

FOR THE PERIOD 1948 - 1961 IN

1. TOTAL FREE WORLD OFFICIAL GOLD HOLDINGS

2. TOTAL FREE WORLD TRADE



Calculated from data in INTERNATIONAL FINANCIAL STATISTICS prepared by the Statistics Section, International Monetary Fund.

C.M.M.A.
May 1962



TRANSCRIPTION BY MEMBER
Nethercut & Young
Toronto, Ontario

Appendix 3

CANADIAN GOVERNMENT GOLD HOLDINGS

At End of Period	Valued in Millions of U.S. Dollars
1951	841.7
1952	885.0
1953	986.1
1954	1,072.7
1955	1,133.9
1956	1,103.3
1957	1,100.3
1958	1,078.1
1959	959.6
1960	885.3
1961	946.2
April, 1962	963.2

TABLE

EXPORTS OF PRINCIPAL METALLIC MINERALS

(Millions of Dollars)

AND AS

PERCENTAGE OF TOTAL COMMODITY EXPORTS

	Gold Available For Export		Other Precious Metals & Manufactures		Copper Primary & Semi-Fabricated		Lead Primary & Semi-Fabricated		Zinc Primary & Semi-Fabricated		Nickel Primary & Semi-Fabricated		Uranium Ores & Concentrates		Iron Ore		Primary Iron & Steel		Certain Other Non-Ferrous Metals		Total excluding Gold		Total (including Gold
	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	%	%
1945	95	3.9	21	.8	37	1.5	17	.7	28	1.1	55	2.2			4	.2	23	9	13	.5	197	8.0	11.9
1947	99	3.4	23	.8	59	2.0	31	1.1	30	1.0	60	2.1			6	.2	39	1.3	17	.6	265	9.1	12.5
1948	119	3.7	25	.8	79	2.4	35	1.1	42	1.3	74	2.3			5	.2	53	1.6	22	.7	335	10.4	14.1
1949	139	4.4	28	.9	87	2.8	42	1.3	56	1.8	92	2.9			14	.4	43	1.4	25	.8	377	12.0	16.7
1950	163	4.9	34	1.0	88	2.6	38	1.1	59	1.8	105	3.2			13	.4	51	1.5	15	.5	404	12.2	17.1
1951	150	3.6	49	1.2	87	2.1	45	1.1	84	2.0	137	3.3			19	5	55	1.6	25	.6	511	12.4	16.0
1952	150	3.3	47	1.0	119	2.6	50	1.1	97	2.2	151	3.4			22	5	85	1.9	46	1.0	517	13.7	17.0
1953	144	3.3	44	1.0	125	2.9	38	.9	58	1.3	163	3.8			31	.7	85	2.0	39	.9	583	13.5	16.8
1954	155	3.8	48	1.2	135	3.3	41	1.0	58	1.4	182	4.4	8	.2	40	1.0	43	1.0	37	.9	592	14.4	18.2
1955	155	3.4	47	1.0	175	3.9	37	.8	71	1.6	215	4.8	27	.6	100	2.2	92	2.0	48	1.1	812	18.0	21.4
1956	150	3.0	56	1.1	205	4.1	35	.7	74	1.5	223	4.4	45	.9	144	2.9	102	2.0	46	.9	931	18.6	21.6
1957	147	2.9	45	.9	169	3.3	29	.6	65	1.3	248	4.9	128	2.5	152	3.0	126	2.5	49	1.0	1012	19.9	22.8
1958	160	3.1	36	.7	142	2.8	26	.5	56	1.1	213	4.2	277	5.4	108	2.1	78	1.5	26	.5	952	18.9	22.0
1959	128	2.8	34	.6	159	3.0	25	.5	55	1.0	227	4.3	312	5.9	158	3.0	112	2.1	23	.4	1105	20.9	23.7
1960	162	2.9	37	.7	224	4.0	26	.5	63	1.1	258	4.6	264	4.8	156	2.8	151	2.7	26	.5	1205	21.7	24.6

*Includes Ores N.O.P., metallic scraps, Cadmium, Selenium Salts, Brass and Manufactures of Brass, and Other Non-Ferrous Metals and Manufactures of Them.

TRANSCRIPTION MEMBER A.S.T.

Nethercut & Heaney
Toronto, Ontario

TRANSCRIPTION BY MEMBER
Nethercut & Young
Toronto, Ontario

Appendix 5

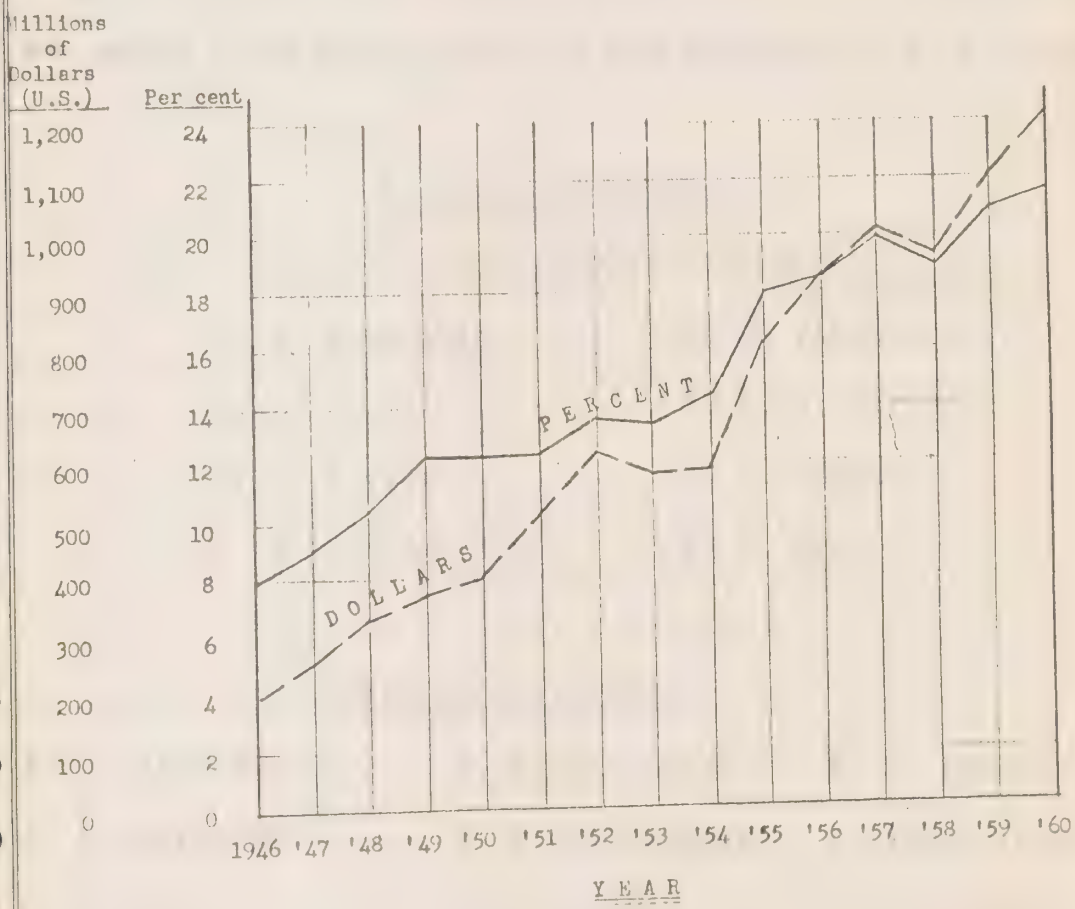
GRAPH SHOWING CANADA'S EXPORTS

of

THE PRINCIPAL METALLIC MINERALS

IN MILLIONS OF DOLLARS AND AS A PERCENTAGE OF CANADA'S TOTAL COMMODITY EXPORTS

FOR THE PERIOD 1946-60



Source: Figures in the accompanying Table of Exports

C.M.M.A.
May 1962



Nethercut & Young
Toronto, Ontario

CANADIAN METAL MINING ASSOCIATION

1962

Officers

President: E. B. Gillanders

1st Vice-President: W. S. Row

2nd Vice-President: R. D. Parker

Treasurer: A. J. Anderson

Vice-President and Managing Director: V. C. Wansbrough

Assistant to Managing Director and Secretary: S. G. Farrar

Executive Committee

E. B. Gillanders, Chairman

J. R. Bradfield
E. L. Brown
H. J. Fraser
W. S. Kirkpatrick
R. D. Parker
J. A. H. Paterson
J. B. Redpath
W. S. Row

Board of Directors

A. J. Anderson
J. D. Barrington
C. M. Beck
R. T. Birks
J. N. Botsford
J. R. Bradfield
E. L. Brown
C. W. Clark
F. M. Connell
W. H. Durrell
M. S. Fotheringham
H. J. Fraser
W. M. Gilchrist
E. B. Gillanders
G. A. Gordon
W. A. Green
W. G. Jewitt
F. R. Joubin
W. S. Kirkpatrick
K. V. Lindell
A. A. McMartin
W. V. Moot
R. C. Mott
F. J. O'Connell
R. D. Parker
J. A. H. Paterson
A. L. Penhale
J. D. Perrin
J. C. Perry
J. B. Redpath
M. A. Roche
W. S. Row
K. J. Springer
J. R. Timmins
V. C. Wansbrough

CANADIAN METAL MINING ASSOCIATION

Officers

President: E. B. Gilladerm

1st Vice-President: W. S. Row

2nd Vice President: R. D. Parker

Treasurer: A. J. Anderson

Vice-President and Managing Director: V. C. Wernerowsk

Assistant to Manager Director and Secretary: S. G. Farm

Executive Committee

E. B. Gilladers, Chairman

J. R. Bradfield — R. D. Parker

E. L. Brown — J. A. H. Peterson

H. J. Fraser — J. B. Redpath

W. S. Kirkpatrick — W. S. Row

Board of Directors

A. J. Anderson	W. M. Gilchrist	R. D. Parker
J. D. Bartlett	E. B. Gilladers	J. A. H. Peterso
C. M. Beck	G. A. Gordon	A. L. Penhale
J. N. Botsford	W. G. Jewitt	J. C. Perry
J. R. Bradfield	R. R. Joubin	J. B. Redpath
E. L. Brown	W. S. Kirkpatrick	M. A. Roche
C. W. Clark	K. V. Lindell	W. S. Row
R. M. Connell	A. A. McMartin	K. J. Springer
M. S. Rolbertsham	R. C. Motz	V. C. Wasbrough
H. J. Fraser	F. J. O'Donnell	

Nethercut & Young
Toronto, Ontario

CANADIAN METAL MINING ASSOCIATION

MEMBER COMPANIES

Algoma Steel Corporation Limited, The - Algoma Ore Division

American Smelting and Refining Company - Buchans Unit

Asbestos Corporation Limited

Aunor Gold Mines Limited

Barnat Mines, Limited

Bell Asbestos Mines Ltd.

Bralorne Pioneer Mines Limited

Broulan Reef Mines, Limited

Caland Ore Company, Limited

Campbell Chibougamau Mines Ltd.

Campbell Red Lake Mines Limited

Canadian Dyno Mines Limited

Canadian Exploration, Limited

Canadian Johns-Manville Co., Limited

Canadian Malartic Gold Mines Limited

Cassiar Asbestos Corporation Limited

Cochenour Willans Gold Mines Limited

Consolidated Discovery Yellowknife Mines Limited

Consolidated Mining and Smelting Company of Canada Limited, The

Copper Rand Chibougamau Mines Ltd.

Delnite Mines, Limited

Denison Mines Limited

Dickenson Mines Limited

Dome Mines Limited

Dominion Magnesium Limited

East Malartic Mines, Limited

Algoma Steel Corporation Limited, The - Algoma Ore Divisi

American Smelting and Refining Company - Bourkena Unit

Asbestos Corporation Limited

Aunor Gold Mines Limited

[illegible] Limited

Bell Asbestos Mines Ltd.

Bralorne Pioneer Mines Limited

Brouton Reef Mines, Limited

Calana Ore Company, Limited

Campbell Chibougamau Mines Ltd.

Campbell Red Lake Mines Limited

Canadian Dyno Mines Limited

Canadian Exploration, Limited

[illegible] Johns-Manville Co.,

[illegible] Mclarnic Gold Mines

Casular Asbestos Corporation Limited

Coniaurum Williams Gold Mines

Consolidated Discovery Yellowknife Mines Limited

Consolidated Mining and Smelting Company of Canada

[illegible]

Denison Mines Limited

Dickenson Mines Limited

Dome Mines Limited

Dominion Magnesium Limited

East Malartic Mines, Limited

East Sullivan Mines Limited

Elder Mines & Developments Limited

Eldorado Mining and Refining Limited

Falconbridge Nickel Mines Limited

Faraday Uranium Mines Limited

Gaspe Copper Mines Limited

Geco Mines Limited

Giant Yellowknife Mines Limited

Granby Mining Company Limited, The

Gunnar Mining Limited

Hallnor Mines, Limited

Heath Steele Mines Limited

Hilton Mines Ltd.

Hollinger Consolidated Gold Mines, Limited

Howe Sound Company

Hudson Bay Mining and Smelting Co., Limited

International Minerals & Chemical Corporation (Canada) Limited

International Nickel Company of Canada, Limited, The

Iron Ore Company of Canada

Johnson's Company Ltd.

Kam-Kotia Porcupine Mines, Limited

Kennco Explorations (Canada) Limited

Kerr-Addison Gold Mines Limited

Labrador Mining and Exploration Company Limited

Lake Shore Mines Limited

Lamaque Mining Company Limited

Leitch Gold Mines Limited

Little Long Lac Gold Mines Limited

Macassa Gold Mines, Limited

Elder Mines & Developments Limited

Eldorado Mining and Refining Limited

Gaspe Copper Mines Limited

Geco Mines Limited

Giant Yellowknife Mines Limited

Granby Mining Company Limited, The

Gunnar Mining Limited

Hallnor Mines, Limited

Heath Steele Mines Limited

Hilton Mines Lt

Hollinger Consolidated Gold Mines, Limited

Howe Sound Company

Hudson Bay Mining and Smelting Co., Limited

International Minerals & Chemical Corporation (Canada) Limited

International Nickel Company of Canada, Limited, The

Iron Ore Company of Canada

Johnson's Company Ltd.

Kam-Kotia Porcupine Mines, Limited

Kenco Explorations (Canada) Limited

Labrador Mining and Exploration Company Limited

Lake Shore Mines Limited

Lamaque Mining Company Limited

Lelon Gold Mines Limited

Little Long Lac Gold Mines Limited

Macassa Gold Mines, Limited

MacLeod-Cockshutt Gold Mines, Limited
Madsen Red Lake Gold Mines Limited
Magnet Cove Barium Corporation
Malartic Gold Fields Limited
Manitou Barvue Mines Limited
Maritimes Mining Corporation Limited
Mastodon-Highland Bell Mines Limited
McIntyre Porcupine Mines, Limited
Mining Corporation of Canada, Limited, The
New Calumet Mines Limited
Newmont Mining Corporation of Canada Limited
Nipissing Mines Company Limited, The
Noranda Mines, Limited
Normetal Mining Corporation, Limited
O'Brien Gold Mines, Limited
Opemiska Copper Mines (Quebec) Limited
Pamour Porcupine Mines, Limited
Paymaster Consolidated Mines, Limited
Pickle Crow Gold Mines Limited
Preston Mines Limited
Quebec Iron and Titanium Corporation
Quemont Mining Corporation, Limited
Rayrock Mines Limited
Renabie Mines, Limited
Rio Algom Mines Limited
Rio Tinto Mining Company of Canada Limited, The
San Antonio Gold Mines Limited
Sheep Creek Mines Limited
Sherritt Gordon Mines Limited
Sigma Mines (Quebec) Limited

Madsen Red Lake Gold Mines Limited

Megnet Cove Barium Corporation

Melantic Gold Fields Limited

Manitou Barvue Mines Limited

Maritimes Mining Corporation Limited

Mastodon-Highland Bell Mines Limited

Mining Corporation of Canada, Limited, The

New Calumet Mines Limited

Newmont Mining Corporation of Canada Limited

Nipissing Mines Company Limited, The

Noranda Mines, Limited

Normetal Mining Corporation, Limited

O'Brien Gold Mines, Limited

Opemiska Copper Mines (Quebec) Limited

Pamour Porcupine Mines, Limited

Raymaston Consolidated Mines, Limited

Pickle Crow Gold Mines Limited

Quebec Iron and Titanium Corporation

Rayrock Mines Limited

Renable Mines, Limited

Rio Algom Mines Limited

Rio Tinto Mining Company of Canada Limited, The

San Antonio Gold Mines Limited

Sheep Creek Mines Limited

Sigma Mines (Quebec) Limited

Steep Rock Iron Mines Limited

Teck-Hughes Gold Mines, Limited, The

United Asbestos Corporation Limited

United Keno Hill Mines Limited

Upper Canada Mines Limited

ViolaMac Mines Limited

Waite Amulet Mines, Limited

Willroy Mines Limited

Wright-Hargreaves Mines, Limited

Yukon Consolidated Gold Corporation Limited, The

Peck-Hughes Gold Mines, Limited, The

United Asbestos Corporation Limited

Upper Canada Mines Limited

Watts Amulet Mines, Limited

Wright-Hargreaves Mines, Limited

Yukon Consolidated Gold Corporation Limited, The

TRANSCRIPTION BY MEMBER
Nethercut & Young
Toronto, Ontario

EXPORT CREDITS INSURANCE CORPORATION

BRIEF

PRESENTED TO

THE ROYAL COMMISSION ON BANKING AND FINANCE

EXPORT CREDITS INSURANCE CORPORATION

I N D E X

SUMMARY

BRIEF

Exhibit 1 Export Credits Insurance Act - Office Consolidation

Exhibit 2 Annual Report and Financial Statements as at December 31, 1961 - in English

Exhibit 3 Annual Report and Financial Statements as at December 31, 1961 - in French

Exhibit 4 Schedule of Investments as at December 31, 1961

Exhibit 5 Orange Booklet - "What it is and How it operates"

Exhibit 6 Analysis by Countries of Actual Risks Underwritten to December 31, 1961

Exhibit 7 Export Finance Corporation of Canada, Ltd. - Pamphlet

Exhibit 8 Government Export Financing - Pamphlet

August 20, 1962

LIST OF EXHIBITS

SUMMARY

Exhibit 1 Export Credits Insurance Act - Office Consolidation

Exhibit 2 Annual Report and Financial Statements as at December 31, 1961 - in English

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Exhibit 7 Export Finance Corporation of Canada, Ltd. - Pamphlet

Exhibit 8 Government Export Financing - Pamphlet

August 20, 1962

Nethercut & Young
Toronto, Ontario

SUMMARY

of Brief to

ROYAL COMMISSION ON BANKING AND FINANCE

By

EXPORT CREDITS INSURANCE CORPORATION
P.O. Box 655, Ottawa

The attached Brief describes the operations of the Export Credits Insurance Corporation in the two fields in which it functions -- export credits insurance, and long term export financing.

Paragraphs 1 to 3 cite the authority under which the Corporation operates and describe briefly the two fields in which the Corporation functions.

Paragraph 4 to 8 detail the composition of the Board of Directors; the Advisory Council; the head office and branch offices, and the number of employees; the capital and surplus of the Corporation; the Corporation's status with respect to income tax; and the policy of the Corporation with respect to investments.

Paragraphs 9 to 17 outline the Corporation's business in the export credits insurance field, and detail its operations under Section 14 under which the Corporation may insure up to a maximum of $200 million on its own account and risk, and also under Section 21 under which the Corporation may insure up to a maximum of $200 million at the risk of the Consolidated Revenue Fund. Under Section 14 the Corporation had a liability of approximately $66

ROYAL COMMISSION ON BANKING AND FINANCE

by

EXPORT CREDITS GUARANTEE CORPORATION

million at December 31, 1961, and under Section 21 the Corporation had a liability for the Government's account of $169 million.

It is the aim of the Corporation to provide insurance on a cost basis. Premiums are charged at rates which will, it is hoped, in the long run just meet the Corporation's operating expenses and net claims. It will be noted from Exhibit A of the financial statements that the excess of premiums over expenses and claims to December 31, 1961, from the inception of the Corporation, amounts to $1,965,560 which is available to meet any claims that may arise in respect of insured export sales outstanding.

The Corporation has insured $1,050,000,000 of exports of which some $410 million were for Government account. Claims paid total $10.5 million with recoveries of $8 million having been obtained.

With the backing of export credits insurance an exporter of general commodities or consumer goods on short term credit can readily obtain financing from his bankers, because the exporter can assign any claims that might arise under his Policy to the bank.

Where medium term credit is involved, i.e. payments spread over one to five years after delivery, the insured exporter can also go to his bank for financing. The bank in turn obtains the necessary funds from the Export Finance Corporation of Canada, Ltd., which the Canadian Chartered Banks set up in April, 1961 specifically to provide a source of financing

for capital goods exported on medium term credit and insured by the Export Credits Insurance Corporation.

ECIC is a member of the international association of credit insurers popularly known as the Berne Union. That organization is a technical body which meets to discuss policies, procedures, premiums, claims, etc. It also is a forum for consideration of appropriate credit terms, and there is an understanding among members that as insurers of suppliers credit they will not provide insurance if terms longer than five years after delivery are involved.

Paragraphs 18 to 24 outline the Corporation's operations in the long term export financing field under Section 21A of the Act. The maximum amount the Corporation may lend is $300 million, and as at December 31, 1961 export contracts totalling $41 million of capital goods had been signed. Commitments had been given to Canadian exporters in connection with the financing of prospective export orders totalling $114 million. In addition, guarantees totalling $31 million had been given under this Section. Thus, $186 million of the $300 million available had been committed as at December 31, 1961.

for capital goods exported on medium term credit and insured by the Export Credits Insurance Corporation.

EMIC is a member of the International Association of credit insurers popularly known as the Berne Union. That organization is a technical body which meets to discuss policies, procedures, premiums, claims, etc. It also is a forum for consideration of appropriate credit terms, and there is an understanding among members that as insurers of suppliers credit they will not provide insurance if terms longer than five years after delivery are involved.

Paragraphs 16 to 24 outline the Corporation's operations in the long term export financing field under Section 21A of the Act. The maximum amount the Corporation may lend is $300 million, and as at December 31, 1961 export contracts totalling $41 million of capital goods had been signed. Commitments had been given to Canadian exporters in connection with the financing of prospective export orders totalling $114 million. In addition, guarantees totalling $31 million had been given under this Section. Thus, $136 million of the $300 million available had been committed as at December 31, 1961.

B R I E F

EXPORT CREDITS INSURANCE CORPORATION

1. The Export Credits Insurance Corporation, a Crown Company, operates under the authority of the Export Credits Insurance Act (Office Consolidation - Exhibit 1), which was originally passed by Parliament in 1944 and has been amended several times since that date.

2. The Corporation operates in two main fields -- that of export credits insurance; and that of long term export financing.

3. Export credits insurance protects Canadian exporters of goods and services exported from Canada against non-payment by foreign buyers. Long term export financing is made available to Canadian exporters of capital equipment where credit terms in excess of five years after delivery are required and certain other criteria are met.

* * *

4. The Corporation is under the management of a Board of Directors composed of the members of the Corporation (the Deputy Minister of Trade and Commerce and the Deputy Minister of Finance), and five other Directors appointed by the Governor in Council (there is one vacancy at present), one of whom is President and General Manager. (See page 16 of the Annual Report for 1961 - Exhibits 2 and 3 - printed in both English and French.) The Governor

EXPORT CREDITS INSURANCE CORPORATION

a Crown Company, operates under the authority of the Export Credits Insurance Act (Office Consolidation - Exhibit 1), which was originally passed by Parliament in 1944 and has been amended several times since that date.

2. The Corporation operates in two main fields that of export credits insurance; and that of long term export financing.

3. Export credits insurance protects Canadian exporters of goods and services exported from Canada against non-payment by foreign buyers. Long term export financing is made available to Canadian exporters of capital equipment where credit terms in excess of five years after delivery are required and certain other criteria are met.

* * *

4. The Corporation is under the management of a Board of Directors composed of the members of the Corporation (the Deputy Minister of Trade and Commerce and the Deputy Minister of Finance), and five other Directors appointed by the Governor in Council (there is one vacancy at present), one of whom is President and General Manager. (See page 16 of the Annual Report for 1961 - Exhibits 2 and 3 - printed in both English and French.) The Governor

in Council may appoint a person to be an alternate Director for a member of the Corporation.

5. There is an Advisory Council of fifteen members, appointed by the Governor in Council, which advises the Board on the administration of the Corporation (page 16 of the Annual Report - Exhibit 2). The head office of the Corporation is at 309 Cooper Street, Ottawa, and branches are maintained in Montreal at 407 McGill Street and in Toronto at 55 York Street. The Corporation is represented in Vancouver, Winnipeg and Halifax by officials of the Department of Trade and Commerce. The Corporation had 46 employees as at June 30, 1962.

6. The authorized and subscribed capital of the Corporation is $15 million (150,000 shares of $100 each) of which $5 million is issued and fully paid. In addition there is $5 million of capital surplus paid in by the Minister of Finance. There is also an Underwriting Reserve of $5 million established out of interest on investments and the excess of premium income over expense and policyholders' claims.

7. The Corporation is a proprietary Crown Company listed in Schedule D to the Financial Administration Act, and as such is subject to income tax in accordance with Section 84 (2) of the Income Tax Act.

8. The Corporation's capital, surplus and reserves are invested in Government of Canada bonds. (See Exhibit 4 for an analysis of the Corporation's investments.) The Board of Directors of the Corporation,

in Council may appoint a person to be an alternate Director for a member of the Corporation.

5. There is an Advisory Council of fifteen members, appointed by the Governor in Council, which advises the Board on the administration of the Corporation (page 16 of the Annual Report - Exhibit 2). The head office of the Corporation is at 309 Cooper Street, Ottawa, and branches are maintained in Montreal at 407 McGill Street and in Toronto at 55 York Street. The Corporation is represented in Vancouver, Winnipeg and Halifax by officials of the Department of Trade and Commerce. The Corporation had 46 employees as at June 30, 1962.

6. The authorized and subscribed capital of the Corporation is $25 million (1,250,000 shares of $100 each) of which $5 million is issued and fully paid. In addition there is $5 million of capital surplus paid in by the Minister of Finance. There is also an Underwriting Reserve of $5 million established out of interest on investments and the excess of premium income over expense and policyholders' claims.

7. The Corporation is a proprietary Crown Company listed in Schedule D to the Financial Administration Act, and as such is subject to income tax in accordance with Section 84 (2) of the Income Tax Act.

8. The Corporation's capital, surplus and reserves are invested in Government of Canada bonds. (See Exhibit 4 for an analysis of the Corporation's investments.) The Board of Directors of the Corporation,

with the approval of the Advisory Council, have established a policy under which the Corporation's investments are to be approximately 25% short term, 25% medium term, and 50% long term.

* * *

Export Credits Insurance

9. The Corporation insures Canadian exporters of goods and services exported from Canada against non-payment by foreign buyers. (For a complete description of the types of insurance available, see the orange booklet - Exhibit 5.)

10. Under Section 14 of the Act the maximum liability the Corporation may assume under contracts of insurance issued and outstanding shall not at any time exceed a total of ten times the aggregate of the amount of the subscribed capital and the surplus of the Corporation, i.e. $200 million. As at December 31, 1961, the liability of the Corporation under contracts of insurance outstanding was $66,110,800.

11. It is the aim of the Corporation to provide insurance on a cost basis. Premiums are charged at rates which will, it is hoped, in the long run just meet the Corporation's operating expenses and net claims. It will be noted from Exhibit A of the financial statements that the excess of premiums over expenses and claims to December 31, 1961, from the inception of the Corporation, amounts to $1,965,560, which is available to meet any claims that may arise in respect of insured export sales outstanding.

with the approval of the Advisory Council, have established a policy under which the Corporation's investments are to be approximately 25% short term, 25% medium term, and 50% long term.

* * *

9. The Corporation insures Canadian exporters of goods and services exported from Canada against non-payment by foreign buyers. (For a complete description of the types of insurance available, see the orange booklet - Exhibit 5.)

10. Under Section 14 of the Act the maximum liability the Corporation may assume under contracts of insurance issued and outstanding shall not at any time exceed a total of ten times the aggregate of the amount of the subscribed capital and the surplus of the Corporation, i.e. $500 million. As at December 31, 1961, the liability of the Corporation under contracts of insurance outstanding was $96,110,300.

11. It is the aim of the Corporation to provide insurance on a cost basis. Premiums are charged at rates which will, it is hoped, in the long run just meet the Corporation's operating expenses and net claims. It will be noted from Exhibit A of the financial statements that the excess of premiums over expenses and claims to December 31, 1961, from the inception of the Corporation, amounts to $1,763,300, which is available to meet any claims that may arise in respect of insured export sales outstanding.

12. Section 21 of the Act provides that

(1) Where the Minister reports to the Governor in Council that

(a) the Board, having regard to the limitations imposed by Section 14, is of opinion that a proposed contract of insurance will impose upon the Corporation a liability for a term or in an amount in excess of that which the Corporation would normally undertake in relation to any one contract, exporter, commodity or country, and

(b) in the opinion of the Minister it is in the national interest that the proposed contract be entered into,

the Governor in Council may approve of and authorize the Corporation to enter into the proposed contract of insurance.

(2) All moneys required by the Corporation to discharge its liabilities arising under any contract of insurance entered into under this section shall be paid to the Corporation by the Minister of Finance out of unappropriated moneys in the Consolidated Revenue Fund. 1948,c.17,s.1.

(3) The liability of the Corporation under contracts of insurance entered into under this section and outstanding shall not at any time exceed two hundred million dollars and shall not be included in the liability of the Corporation for the purposes of section 14.

12. Section 21 of the Act provides that

(1) Where the Minister reports to the Governor in

(a) the Board, having regard to the limitations imposed by Section 14, is of opinion that a proposed contract of insurance will impose upon the Corporation a liability for a term or in an amount in excess of that which the Corporation would normally undertake in relation to any one contract, export, commodity or country, and

(b) in the opinion of the Minister it is in the national interest that the proposed contract be entered into,

the Governor in Council may approve of and authorize the Corporation to enter into the proposed contract of insurance.

(2) All moneys required by the Corporation to discharge its liabilities arising under any contract of insurance entered into under this section shall be paid to the Corporation by the Minister of Finance out of unappropriated moneys in the Consolidated Revenue Fund. 1948, c.17, s.1.

(3) The liability of the Corporation under contracts of insurance entered into under this section and outstanding shall not at any time exceed two hundred million dollars and shall not be included in the liability of the Corporation for the purposes of section 14.

(4) The Corporation shall maintain a separate account of all receipts and disbursements arising out of contracts entered into under this section and shall, if the Minister of Finance so directs, pay to the Receiver General of Canada any part of such receipts that the Minister considers to be in excess of the amount required to meet the expenses and overhead of the Corporation arising out of such contracts.

13. The Corporation retains 25% of the premiums collected under Section 21 contracts of insurance to meet expenses and overhead, the balance being remitted to the Receiver General. As at December 31, 1961 the liability of the Corporation under contracts of insurance entered into under Section 21 of the Act was $168,902,187.

14. The total volume of business insured by the Corporation under Section 14 from the commencement of operations in 1945 until December 31, 1961 was $640,256,199. Export sales insured under Section 21 totalled $410,388,716. (See Exhibit 6 for analysis by countries of insured export sales.) There have not been any claims paid under Section 21 business. To December 31, 1961 total claims paid under Section 14 insurance amounted to $10,476,608 and recoveries obtained totalled $7,989,031. Of the balance of $2,487,577, $382,169 has been written off. Upon direction by the exporter, the Corporation will agree to pay to any Canadian Chartered Bank the proceeds of any claim which may become payable under an exporter's

(d) The Corporation shall maintain a separate account of all receipts and disbursements arising out of contracts entered into under this section and shall, if the Minister of Finance so directs, pay to the Receiver General of Canada any part of such receipts that the Minister considers to be in excess of the amount required to meet the expenses and overhead of the Corporation arising out of such contracts.

17. The Corporation retains 25% of the premiums collected under Section 21 contracts of insurance to meet expenses and overhead, the balance being remitted to the Receiver General. As at December 31, 1961 the liability of the Corporation under contracts of insurance entered into under Section 21 of the Act was $16,602,302,167.

18. The total volume of business insured by the Corporation under Section 14 from the commencement of operations in 1945 until December 31, 1961 was $40,252,199. Export sales insured under Section 21 totalled $410,328,716. (See Exhibit 6 for analysis by countries of insured export sales.) There have not been any claims paid under Section 21 business. To December 31, 1961 total claims pain under Section 14 insurance amounted to $10,476,608 and recoveries obtained totalled $7,386,031. Of the balance of $2,487,577, $358,169 has been written off. Upon direction by the exporter, the Corporation will agree to pay to any Canadian Chartered Bank the proceeds of any claim which may become payable under an exporter's

Policy. Accordingly, with the backing of export credits insurance an exporter of consumer goods can obtain credit from his bankers to finance his export sales.

15. In order to assist in financing capital goods sold on medium term credit, i.e. with payment terms spread over one to five years, the Canadian Chartered Banks in April 1961 set up the Export Finance Corporation of Canada, Ltd. (see Exhibit 7), which specifically provides financing for capital goods exports which have been insured by ECIC. The exporter continues to deal with his banker and the banker in turn uses the Export Finance Corporation as a re-discount facility.

16. The establishment of the Export Finance Corporation of Canada, Ltd. provides Canadian exporters with a new and distinctly separate source of funds for export financing, inasmuch as with the backing of its authorized $50 million capital, the Export Finance Corporation has the authority under its charter to borrow up to $500 million.

17. ECIC is a member of the international association of export credits insurers "Union d'Assureurs des Credits Internationaux" (Berne Union), which was founded in 1934. There are eighteen member countries representing the majority of the large trading nations of the world. One of the main objectives of the Union, besides discussing the results of members' experience in importing countries, is to exchange information on credit terms for various

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commodities. The members of the Union, as insurers of suppliers' credit, are strongly of the opinion, and have an understanding among themselves, that even for the very heaviest of capital equipment a maximum of five years' credit after delivery should not be exceeded. If credit terms in excess of five years are clearly necessary and desirable, it is the view of Berne Union members that financing other than on a basis of suppliers credits should be provided.

Long Term Export Financing

18. Under Section 21A of the Act, the Corporation may, with the authority of the Governor in Council, provide long term financing for export sales of capital goods up to a total of $300 million.

19. The guiding rules that determine the eligibility of transactions for long term financing are that the extended credit terms are clearly necessary and justifiable; that the transaction gives promise of continuing export trade; that the Canadian content is not less than 80%; that the transaction gives rise to significant employment and industrial benefits in Canada; that the export transaction is substantial in value, at least $2 million; and that the foreign buyer and country of purchase have a satisfactory credit standing. (See pages 15 and 16 of the orange booklet and the pamphlet entitled "Government Export Financing", Exhibits 5 and 8.)

20. The application for export financing is made by the Canadian exporter to the Export Credits Insurance Corporation. Only in exceptional circumstances may a

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line of credit be committed to a foreign country. The proceduresof financing the particular project or transaction follow the standard practice of requiring an application by the Canadian exporter and formal commitment of the financing by Order-in-Council.

21. The Export Finance Division of ECIC upon receipt of an application studies all aspects of the proposal for financing and investigates the case in such detail as may be required through the applicant company, Trade Commissioners abroad, and other appropriate sources. After this review, applications are submitted to an interdepartmental Committee on Export Finance and those applications meeting the established criteria are recommended to the Minister of Trade and Commerce for submission to Cabinet.

22. As provided by Section 21A of the Export Credits Insurance Act, payments are made to the Canadian exporter by means of purchasing Promissory Notes issued by the importer endorsed without recourse by the exporter to ECIC and to which has been attached the guarantee of ECIC. Such advances by ECIC are made in accordance with the conditions of a financing agreement entered into between the foreign buyer, the exporter, and ECIC, either as progress payments during the period of manufacture of capital equipment or against the periodic deliveries of such equipment. Moneys required by ECIC to purchase these notes are drawn as required from the Consolidated Revenue Fund.

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23. All payments received by ECIC in amortization of Promissory Notes in the series of, normally, equal semi-annual notes corresponding to the principal amount of the financing provided are immediately paid by ECIC to the Consolidated Revenue Fund. All payments on account of interest received by ECIC are also paid to the Consolidated Revenue Fund except for an amount of interest of 1/4 of 1% retained by ECIC to cover the administrative expenses of operating the export financing programme.

24. To December 31, 1961 contracts had been signed covering $41 million of capital goods (see page 13 of Annual Report, Exhibit 2). Commitments had been given to Canadian exporters in connection with the financing of prospective export orders totalling $114 million. In addition, guarantees totalling $31 million had been given under Section 21A and were in effect at December 31, 1961. Thus, $186 million had been committed under Section 21A long term financing.

August 20, 1962

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August 20, 1962

EXHIBIT 4

EXPORT CREDITS INSURANCE CORPORATION

SCHEDULE OF INVESTMENTS AS AT DECEMBER 31, 1961

Maturity	Rate	Amount	Market	Book	Percentage
Jan. 26/62	Tr. Bill	$ 600,000	$ 598,828	$ 598,828	
June 15/62	3 %	500,000	500,250	500,000	23.7
[illegible] 1/63	4 %	500,000	502,250	499,040	
[illegible]ne 1/63	2 3/4 %	2,650,000	2,626,150	2,624,972	
		$ 4,250,000	$ 4,227,478	$ 4,222,840	
[illegible]. 1/65	3 3/4 %	3,350,000	3,312,312	3,281,038	24.5
[illegible]une 15/67/68	2 3/4 %	1,050,000	966,000	1,043,581	
		$ 4,400,000	$ 4,278,312	$ 4,324,619	
Sept. 1/72	4¼ %	1,100,000	1,057,375	999,174	
June 1/74/76	3½ %	1,850,000	1,537,813	1,849,537	51.8
Oct. 1/79	3½ %	1,800,000	1,451,250	1,800,000	
Sept. 1/83	4½ %	4,550,000	4,254,250	4,550,000	
		$ 9,300,000	$ 8,300,688	$ 9,198,711	
		$ 17,950,000	$ 16,806,478	$ 17,746,170	100.0

EXPORT CREDITS INSURANCE CORPORATION

EXHIBIT 6 (1)

Analysis by Countries of Actual Risks Underwritten to December 31, 1961

Country	Amount at the Government's Risk Under Section 21	Amount at the Corporation's Risk
Commonwealth		
Aden	$	$ 450
Australia		29,676,899
Bermuda		1,323,721
Borneo		27,017
British East Africa		140,869
British Guiana		2,244,828
British Honduras		281,499
British West Africa		72,023
British Oceania		44,033
Ceylon		586,222
Cyprus		49,324
Fiji Islands		44,275
Ghana		6,399,122
Gibraltar		890
Hong Kong		1,331,843
India		9,855,167
Malaya		1,637,486
Malta		1,995
Mauritius		1,740
Newfoundland		415,591
New Zealand		14,243,940
Nigeria		1,319,729
Pakistan		324,958
Rhodesia & Nyasaland		1,037,840
Sierra Leone		6,704
South Africa		41,374,032
United Kingdom		92,915,487
West Indies Federation		24,988,511
Total Commonwealth Countries	$ --	$230,346,195

EXPORT CREDITS INSURANCE CORPORATION EXHIBIT 6 (2)

Analysis by Countries of Actual Risks Underwritten to December 31, 1961

Country Foreign	Amount at the Government's Risk Under Section 21	Amount at the Corporation's Risk
Arabia	$	$ 195,408
Argentina		30,229,786
Austria		850,640
Bahrein Islands		8,252
Belgium		17,206,626
Bolivia		1,756,525
Brazil	25,809,925	36,092,418
Burma		350,096
Caroline Islands		837
Chile		10,819,114
China		2,627,535
Colombia		16,756,153
Congo		3,969,220
Costa Rica		3,197,009
Cuba		19,118,544
Czechoslovakia	47,449,175	3,834,412
Denmark		1,823,568
Dominican Republic		5,274,014
Ecuador		3,124,949
Egypt		2,497,713
El Salvador		1,691,645
Ethiopia		6,061
Finland		2,200,872
France		21,493,104
French Africa		4,743,949
French Guiana		1,348
French Oceania		116,677
French West Indies		22,523
Gabon Republic		8,448
German Fed. Rep.	80,034,161	19,672,562
Germany East		107,387
Greece		6,388,095
Guam		41,714
Guatemala		3,861,672
Haiti		905,220
Hawaii		609
Honduras		820,463
Hungary	2,586,219	17,129
Iceland		236,154
Indonesia		636,552
Iran		1,529,073
Iraq		1,491,390
Ireland		4,766,717
Israel	12,429,087	1,660,337
Italy		16,617,115
Japan		6,731,863
Jordan		38,693
Kuwait		63,870
Lebanon		1,054,469
Liberia		52,563

Continued

Country	Amount at the Government-held Mint Issue	Amount at the Opposition-held Mint
Section 21		
Angola	$	$
Argentina		
Bolivia		
Brazil		
Chile		
Colombia		
Costa Rica		
Cuba		
Dominican Republic		
Ecuador		
El Salvador		
Guatemala		
Haiti		
Honduras		
Mexico		
Nicaragua		
Panama		
Paraguay		
Peru		
Uruguay		
Venezuela		

EXPORT CREDITS INSURANCE CORPORATION EXHIBIT 6 (3)

Analysis by Countries of Actual Risks Underwritten to December 31, 1961

Country	Amount at the Government's Risk Under Section 21	Amount at the Corporation's Risk
Foreign (cont'd)		
Libya	$	$ 13,575
Luxembourg		11,719
Malagasy Republic		256,577
Mariana Islands		2,126
Marshall Islands		21,821
Mexico	15,309,269	23,516,171
Morocco		148,253
Netherlands		9,797,234
Netherlands Antilles		1,741,052
Nicaragua		2,028,812
Norway		1,560,951
Panama		2,767,051
Paraguay		574,589
Peru		6,029,913
Philippines		253,224
Poland	124,577,059	616,057
Portugal		2,839,841
Portuguese Africa		284,723
Portuguese Asia		4,848
Puerto Rico		3,136,355
Reunion Island		98
St. Pierre & Miquelon		398,452
Samoa		9,885
Spain		586,487
Sudan		283,445
Surinam		845,924
Sweden		9,809,746
Switzerland		8,032,826
Syria		1,875,556
Taiwan		23,071
Thailand		904,379
Turkey		16,701,215
United States of America	80,215,748	16,755,910
Uruguay		4,584,589
U.S.S.R.		20,750
Venezuela	3,938,428	36,033,693
Virgin Islands		3,979
Yugoslavia	18,039,645	724,014
Total Foreign Countries	$410,388,716	$ 409,910,004
Total All Countries	$410,388,716	$ 640,256,199
Grand Total All Countries		$1,050,644,915